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Regulatory Harmonics

Balancing Innovation and Control in Finance

Foreword

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The growth of the Indian fintech ecosystem is not just remarkable; it is a testament to the country's robust financial evolution. This growth is multifaceted, propelled by substantial venture capital investments, government-led initiatives, and a fertile ground for innovation. Initiatives like Digital India, India Stack, Unified Payments Interface (UPI), and the JAM Trinity (Jan Dhan-Aadhaar-Mobile) have collectively propelled India into the digital age, establishing it as a global frontrunner in fintech innovation.

However, this meteoric rise in fintech is not without its unique set of challenges. The rapid digital transformation has raised critical concerns over data privacy and security, consumer protection, grievance redressal mechanism and financial stability. Recognizing these challenges, financial sector regulators are proactively shaping a regulatory framework. Their objective? To nurture innovation while prioritizing consumer protection and maintaining the stability of the financial sector.

Globally, we have seen in the past how minimal regulation, coupled with lenient supervision has often led to financial crises. Nothing could be more detrimental to sustainable growth than a malfunctioning banking and financial sector. Thus, regulatory oversight becomes necessary to prevent irrational exuberance and to maintain financial stability.

For a regulator, inaction can never be an option. The pace at which newer business models, players, and products are arising proves to be challenging due to the risk of such players often exploiting regulatory gaps. Business models that are built to challenge the regulatory perimeters, aggressive marketing strategies, and those that are engaged in exploitation of gullible customers make it clear that such issues need intervention.

This report provides a brief coverage on the recent regulations within different verticals of fintech i.e. lending, insurance, payments, investments, and allied activities. It seeks to detail the purpose behind such regulations and their impact on businesses. Furthermore, it also provides a brief comparison of regulations amongst different jurisdictions, while also elaborating on various initiatives taken by financial sector regulators in India.

That being said, financial sector regulators are keeping pace with innovations across the financial sector to enable access to suitable, sustainable financial products to a billion Indians in a secure, seamless manner.

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The Regulatory Landscape of Financial Technology

There have been diverse approaches with respect to the regulation of emerging financial technologies across the world, with regulators varying their approach based on factors such as risk, collaboration with industry leaders, sector-based use principles, technology ethics and public sector inclusivity.

The following table provides a brief landscape of the existing regulations in place and the approach taken by the mentioned regulators towards developments in their jurisdictions.

	India	USA	Singapore	European Union
Relevant Regulatory Authorities	Apart from overarching legislations such as the DPDP Act, sector-specific regulators in the financial space are broadly – the RBI (banking and monetary services); SEBI (securities and exchanges); and IRDAI (insurance).	Similar to India, the USA at a central level has regulatory bodies established across sectors, namely, the Federal Reserve (financial system and monetary policy) and the Securities and Exchange Commission (securities) – among others. However, certain industries are also regulated on a state level, such as insurance.	A central authority, the Monetary Authority of Singapore ("MAS") regulates banking, capital markets, insurance and payments.	The European Central Bank ("ECB") acts as the central bank for euro adopting countries, whose directives are then adopted by the banking system of individual member states such as the Payment Services Directive ("PSD2") which mandates open banking. The other regulatory bodies are responsible for micro prudential oversight, namely – European Banking Authority ("EBA"), The European Securities and Markets Authority ("ESMA") and The European Insurance and Occupational Pensions Authority ("EIOPA").

Areas Facing Regulation	The RBI has frameworks for the regulation of – digital lending and technology-driven payment structures such as payment aggregators, payment gateways and account aggregators. SEBI has recognized fintech developments in the securities market through timely regulations such as those on algorithmic trading.	Regulation is fragmented owing to the nature of US governance. For instance, while the Department of Justice ("DOJ") broadly regulates cryptocurrency through its National Cryptocurrency Enforcement Team, each state has a different regulatory stance on crypto regulation.	As the MAS is the central regulatory body, it comprehensively regulates fintech developments in Singapore. This ranges from digital lending to payment solutions.	Presently, while there are EU legislative proposals on fintech and digital finance, no single piece of EU legislation covers all aspects of fintech. The EU has proposed the adoption of AI Regulation Act, which seeks to categorise AI applications according to risk.
Regulator Initiatives Encouraging Growth	Regulatory sandboxes have been established by RBI, IRDAI, etc. Applications for RBI's regulatory sandbox are on a cohort basis. Regulatory bodies also conduct hackathons to further foster innovation.	Establishment of regulatory sandboxes in some states.	No industry- specific regulatory sandbox. Applications for the fintech regulatory sandbox are on a rolling basis.	Established sandboxes in the EU, including for blockchain and AI.
Public Consultation requirements with respect to emerging Technologies	RBI seeks public comments for any draft guidelines released. For instance, the RBI has public comments from the public for the draft IT Outsourcing Guidelines and the draft RBI (Government Securities Lending) Directions, 2023. Further, SEBI has also issued circulars requiring stakeholders using AI/machine learning technologies to report such usage.	"Notice and comment rulemaking" by the FCC aims at securing public comments before establishing new laws.	CCCS seeks public consultation from stakeholders for establishing new legislation and policies.	The EU seeks public consultation for introducing new laws. The European Commission also publishes a statistical analysis of the feedback received from respondents, making this one of the most transparent processes of this kind.

Lending

1 Digital Lending

Digital lending is a remote and automated lending process, largely by use of seamless digital technologies for customer acquisition, credit assessment, loan approval, disbursement, recovery, and associated customer service.

Intent

The rise of digital banking was bolstered by the introduction of tech-driven initiatives such as the India Stack APIs and the recognition given to financial technologies by the RBI in the form of regulations such as those guiding payment aggregators, prepaid instruments etc. As a result, digital lending was on the rise, with unregulated digital entities entering into partnerships with banks and NBFCs to offer loans in the form of products such as "buy now pay later" ("BNPL"). Along with the seamless ease in accessing lending, it also gave rise to malpractices such as mis-selling, unethical means of recovery, data breaches – often to an unsuspecting poorer section of society.

As a response, the RBI constituted a working group on digital lending on January 13, 2021, which laid down certain baseline compliances. It laid down the division of obligations amongst stakeholders, which it identified as Regulated Entities ("RE"), Lending Service Providers ("LSP") and the Digital Lending Applications ("DLA"). Largely, REs such as banks and NBFCs must ensure that the DLAs and LSPs engaged by them adhere to these Guidelines.

Impact

The Guidelines on Digital Lending ("DL Guidelines") were enacted in 2022, which forced a large number of fintech firms to redo their business models. REs were shouldered with a greater compliance burden when entering into such partnerships. For instance, the DL Guidelines earlier completely prohibited "first loss default guarantee" ("FLDG") arrangements between the RE and the LSP, prior to which LSPs would guarantee as much as 100% of the portfolio amount. Responding to industry concerns about a complete prohibition, the FLDG guidelines of June 2023 introduced a cap of 5% of the portfolio amount instead.

The DL Guidelines now introduce multiple changes to existing practices of lending REs and their partners, with the aim of increasing protection to customers. Some of these necessitate changes to lending models and the underlying fund flows, while others are introduced to bring in increased transparency, protection of customer data, and effective grievance redressal. Under the guidelines, it is the responsibility of REs to ensure that LSPs and DLAs comply with the DL Guidelines, where such an entity performs one or more lending function as outsourced by the RE. The DL Guidelines are also applicable to EMI programs on Debit and Credit Cards. For instance, loans offered on Debit Cards, including EMI programmes. In short, anything which not covered under the 'Master Direction on Credit Card and Debit Card – Issuance and Conduct, 2022' – will be covered under the DL Guidelines.

Key Considerations	Guidelines	Intent and Impact
Data Reading	REs are responsible towards ensuring that DLAs and LSPs access data only on a need-basis and that they desist from accessing. customer mobile phone resources like files and media, contact lists, call logs, telephony functions, etc. A one-time access can be taken for camera, microphone, location or any other facility necessary for the purpose of on-boarding/ KYC requirements only, with the explicit consent of the borrower.	The regulation has impacted companies that used mobile phone resources to determine expenditure trends, behavior patterns, etc used especially to underwrite new-to-credit (NTC) customers. Further, given the current group structure of entities where they act as both LSPs and REs, it has become difficult to customise the onboarding and underwriting journey for the borrowers.
Default Loss Guarantee ("DLG")	REs are required to ensure that the total amount of DLG cover does not exceed 5% of the amount of the loan portfolio. It is important to note that the guidelines also prescribe the form factors in which the guarantees can be taken. The guidelines also mention that any other implicit guarantee of similar nature linked to the performance of the loan portfolio of the RE and specified upfront shall also be covered under the definition of DLG.	DLG was previously disallowed in India during the time between the issue of the DL Guidelines (September 2022) and FLDG guidelines (June 2023). The current loan portfolio cap of 5% shall help REs to cover potential losses that occur when customers default on payments. However, the market continues to identify the opportunity to engage in higher risk sharing by not explicitly mentioning the words "guarantee" or "linking with the performance of portfolio" in their agreements. Earlier, due to renting a license model (taking 100% FLDG cover) various guidelines issued by RBI such as KYC, PEP, etc were not being followed by REs. This cap has brought an end to the same.
Recognition of Non-Performing Assets ("NPA")	Recognition of individual loan assets in the portfolio as NPA and consequent provisioning shall be the responsibility of the RE, as per extant asset classification and provisioning norms, irrespective of any DLG cover available at the portfolio level. The amount of DLG invoked shall not be set off against the NPA.	By not allowing the guaranteed income to be set off against the bad loans and accounting the income as other income will result into higher incidence of tax i.e. GST implication on the income. This has also brought transparency and provided a clear and better view of NPAs.
Storage of Data	LSPs and DLAs engaged by the REs are permitted to store only need-based basic minimal details (such as name, contact details etc.) of the customers, and only with their explicit consent.	Provides additional safeguards for the customers, ensuring that their data is not misused. The guidelines also need to be read with the Digital Data Protection Act, 2023

Key Considerations	Guidelines	Intent and Impact
Key Fact Statement ("KFS")	REs are required to provide a standardised KFS to the borrower before the execution of the loan contract. The KFS must contain the details of all the fees, charges such as annual percentage rate, processing fee, prepayment charges, etc which can be levied on borrowers and should also mention the recovery mechanism, details of grievance redressal officer designated specifically to deal with digital lending/ FinTech related matter and the cooling-off/ look-up period. Any fees, charges, etc., which are not mentioned in the KFS cannot be charged by the REs to the borrower at any stage during the term of the loan.	Disclosure of KFS to the customers allows them to take more informed decisions regarding their loan as the relevant information is present in a consolidated and transparent manner at one place.
Loan Disbursal, Servicing and Disbursement	With respect to digital lending particularly, LSPs should not be involved in handling of funds flowing from the lender to the borrower or vice versa. Exceptions have been carved out for specific end use case (wherein the funds may be transferred directly to the accounts of the end-beneficiary) and co- lending transactions between REs. An exception has also been carved out for delinquent loans, wherein the funds may be recovered by recovery agents in cash. Any recovery in cash must reflect in the borrower's account. Fees, charges etc. to be paid to LSPs must be paid by REs, and not charged to the borrower.	Negatively impacted the national incident management system of LSPs. Operationally cumbersome for LSPs due to change in the movement of fund flow structure i.e., earlier, LSPs used to deduct their share from EMI before transferring the funds to RE as opposed to now where LSP raises the invoice on REs for its share.
Cooling/ Look-off period	'Cooling / look-off period' refers to the time window provided by REs to borrowers for exiting digital loans, in case a borrower decides not to continue with the loan. Cooling period cannot be less than 1-3 days depending upon the tenor of loans.	To provide more flexibility to borrowers. Currently, only reasonable processing fee and proportionate APR can be charged without any penalty.

Note:
DL guidelines will also be applicable to EMI programs on Debit and Credit Card eg: loans offered on Debit Card, including EMI programmes. In short, anything which is not covered under 'Master Direction on Credit Card and Debit Card – Issuance and Conduct, 2022' – to those DL guidelines will be applicable.

2 Lending–Other Key Updates

Key Considerations	Guidelines	Intent and Impact
Recognition of NPA	The RBI has updated its prudential norms on income recognition, asset classification and provisioning pertaining to advances. Per this, NBFCs have to classify their NPA accounts exactly from the overdue date unlike the earlier practice of counting of days from the end of the month in which the account becomes NPA . Further, loan accounts classified as NPAs may be upgraded as 'standard' assets provided that the entire arrears of interest and principal are paid by the borrower.	This will bring transparency and ensure higher degree of corporate governance with improved consistency in accounting.
Fair Practice Code	RBI has recently released a notification with respect to levying penal charges on the credit facilities being extended by them. The term "penal interest" will be replaced with "penal charges". Penal interest/ charges are an additional charge a lender levies on a borrower in case of delay in payment of equated monthly installments (EMI) or default or non-compliance of material terms and conditions. Further, the circular clarifies that there shall be no capitalization of penal charges (not to be added in outstanding EMIs) i.e., no further interest would be computed on such charges. Furthermore, the penal charges will be same across all products i.e., an entity cannot levy different charges for different products. The circular shall not apply to credit cards, ECB, trade credit and structured obligations.	The move is aimed at reducing customer grievance and disputes, but may also result in reduce earnings of regulated entities.
Increase in Risk weights for Consumer Credit	RBI has recently released a notification to increase the risk weight by 25% in respect of consumer credit exposure of both scheduled commercial banks and NBFCs on both outstanding and new loans. RBI has carved out housing loans, education, vehicle loans and loans secured by gold and microfinance/SHG loans from the list. Further, bank credit to NBFCs has also been increased by 25% except for HFCs and loans to NBFCs which are eligible for classification as priority sector. Further, the REs shall review their extant sectoral exposure limits for consumer credit and put in place board approved limits with respect to various segments under consumer credit. In particular, limits shall be prescribed for all unsecured consumer credit exposures. The limits so fixed shall be strictly adhered to and monitored on an ongoing basis by the Risk Management Committee.	Due to the significant rise in unsecured lending and early signs of payment issues in this type of loan category, RBI has taken early measures to address and control this trend. This will lead to an increase in the lending rates by at least 10-15 basis points for consumers. However, the interest rate impact would vary from lender to lender. Banks with relatively higher exposure to unsecured advances on their loan books may react more sharply than banks that don't have it. Further, we may witness a surge in demand for securitization, and co- lending may also see an uptick.

Investments

1 Online Bond Platform Providers

An Online Bond Platform Provider ("OBPP") is a SEBI-registered platform that facilitates the buying and selling of bonds. These platforms act as intermediaries, providing investors with bond investment choices and enabling seamless bond transactions. OBPPs leverage technology to simplify the bond investment process, making it more accessible and efficient for non-institutional investors.

Intent

With the uptick in fintech in India, technological platforms started offering bonds to investors. Online bond platforms, at times, provided investment opportunities through unlisted debt securities, presenting alternative investment options akin to conventional debt offerings. Also, information and risks of these offerings were often not complete outside the regulated mechanism, orders were being settled bilaterally and riskier bonds were inappropriately marketed as fixed deposit (FD) alternatives. In addition, the absence of an investor grievance mechanism raised significant concerns due to the lack of normal regulation. Nevertheless, SEBI intervened to tackle this problem. In November 2022, the SEBI brought OBPPs under its purview by implementing a regulatory framework to ensure the long-term growth and success of India's bond market.

SEBI has placed certain checks and balances on OBPPs in the form of the SEBI Circular on Adherence to provisions of regulation 51A of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 by Online Bond Platform Providers on product offerings on Online Bond Platforms dated June 16, 2023. OBPPs are restricted from offering products other than listed eligible securities on their platforms including government securities, treasury bills, listed sovereign gold bonds, listed municipal debt securities, and listed securitized debt instruments on their online bond platforms.

As of December 2023, OBPPs are also expected to issue an electronic order receipt, deal sheet and quote receipt so as to ensure ease of doing business and transparency.

Impact

OBPPs enhance bond offerings by curating and presenting them with professional knowledge, ensuring better selection and organization. Moreover, these platforms provide convenient access to information, making bond buying more user-friendly. Additionally, OBPPs contribute to investor education and awareness, helping individuals become more informed participants in the bond market, thereby improving the overall level of investor knowledge. OBPPs have transformed the bond market in India, offering increased accessibility, transparency and efficiency to investors. These platforms have empowered retail investors, enabling them to participate in bond investing and access opportunities previously available only to institutional investors. As OBPPs continue to advance, they will play a crucial role in shaping the future of the Indian bond market, strengthening its infrastructure and contributing to overall economic growth.

Key Considerations	Guidelines	Intent and Impact
Unregulated products/securities	OBPP shall not have on its Online Bond Platform or any other platform/website, any link or tab to websites/ platforms that offer products/securities which are not regulated by a financial sector regulator. Further any entity/third party should not utilise any name resembling to that of OBPP to offer unregulated products.	The intent is to prevent users from subscribing to unregulated products / securities. We envisage a negative impact on the earnings of the platform as now they can only offer eligible securities on their platform.
Registration for license	OBPPs will need to acquire a stock broking license. Further, basis the type of stock broker such an OBPP is registering as, the OBPPs must have a base net worth varying anywhere between INR 1 crore to up to INR 50 crores by February 23, 2024. The variable net worth must be 10% of the average daily cash balance of clients retained with members across segments/ exchanges in the previous 6 months. To receive a license to operate as an OBPP, OBPPs require to comply with conditions laid down in Regulation 5 of the Stock Brokers Regulations.	To put checks and balances in order to mitigate payment and settlement risk. Users will be able to avail grievance redressal mechanisms in case of customer complaints
Execution of Orders	Listed debt securities placed on OBPPs are mandatorily routed through the 'Request for Quote' platform (RFQ) of the recognised stock exchange(s) and settled through the respective clearing corporations.	Mitigates payment and settlement risk for both primary and secondary sale of bonds.
Minimum Disclosure Requirement	OBPPs must make certain disclosures for each debt of security offered for sale on the platform, such as providing the name of the issuer, the nature of instrument, original mode and date of issue, coupon (fixed/floating, rate/value, frequency), offer documents (prospectus / private placement memorandum) etc.	Ensures transparency and informed decision making. Additionally, the disclosure towards conflict of interest may avoid potential concerns.

2 Algorithmic Trading

Algorithmic trading, known colloquially as "Algo Trading" is a method of executing trading orders by providing a predefined set of orders, conditions and rules to a computer program, that will then execute these orders accordingly. While a user can build an algorithm and deploy it to generate buy or sell signals, manual intervention is required for placing orders, as full automation is not permitted for retail traders.

Intent

SEBI provided institutions with the Direct Market Access (DMA) facility on 3rd April 2008, and thus introduced algorithmic trading into the market as a mainstream practice. This facility allows brokers to share technological infrastructure with their clients and providesdirect access to the exchange trading system, which in turn allows the broker clients to use algorithms to place trades.

SEBI has noted that algorithmic trading services and strategies are marketed claiming high returns on investment by various unregulated platforms. Some of the algo strategies are even assigned ratings, which SEBI rightly believes to constitute mis-selling of services and strategies to unsuspecting investors. SEBI has further noted that in certain instances, stockbrokers are providing algorithmic trading facilities through such unregulated platforms. In view of the risks associated with this unregulated activity, with the lack of adequate investor protection and grievance redressal mechanisms, the regulator has mandated that stockbrokers providing algo trading services shall neither make any direct or indirect reference to the past or expected future returns or performance of the algorithm, nor shall it associate with any platform providing such references.

Recognising the need for increased regulation, Paragraph 55 of the Master Circular for Stock Brokers dated May 17, 2023 lays down broad guidelines on Algorithmic Trading. Furthermore, the circular on performance / return claimed by unregulated platforms offering algorithmic strategies for trading dated September 2, 2022 was released by SEBI in light of the concern related to stockbrokers providing algorithmic trading facility to investors through unregulated platforms.

Impact

Algorithmic trading is able to effectively combine several existing strategies and techniques employed by brokers and market professionals in the present day. With the recent development of AI and ML technologies, strategies such as "Quant Trading" can be easily replicated and improved upon by a trading algorithm in ways that a human trader may not foresee. Similarly, algorithmic trading has the ability to revolutionize technical analysis in this industry and is thus expected to be a highly disruptive technology to existing trading practices.

Key Considerations	Guidelines	Intent and Impact
Performance and Return	Stockbrokers providing services relating to algorithmic trading shall not directly / indirectly: • make any reference to the past / expected future return / performance of the algorithm; and /or • associate with any platform providing any reference to the past/ expected future return/ performance of the algorithm.	It has been observed that algorithmic services and strategies are often marketed with "claims" of high returns on investment. Further, "ratings" have been assigned to the strategies, which could lead to investors being lured by such claims. Preventing such references and associations shall ensure that there are no acts of mis-selling, thus protecting the interest of investors in the securities market.
Approval of Algorithm	A new algorithm or amendments made in the existing algorithm will require the approval from stock exchange via registered stock broker. Moreover, the broker will be held liable in case of any unintended consequences	Stock exchanges aim to mitigate risks associated with using algorithms for trading purposes. There will be a lack of frictionless and seamless execution due to approval requirements
Type III broker	Brokers who may be registered as Type II brokers and who are also undertaking algorithmic trading facility to trade will be eligible to get type III Broker license Such brokers also have to mandatorily get their systems audited half yearly.	This could lead to an increase in cost of compliance

3 Family Investment Funds

The International Financial Services Centres Authority (Fund Management) Regulations, 2022 ("FM Regulations") gave formal recognition to family offices. A Family Investment Fund ("FIF") has been defined as a self-managed fund pooling money only from a single family, or entities wherein members of the single-family exercise control and have substantial economic interest (at least 90%), set up as a fund management entity ("FME") in terms of FM Regulations.

Guidelines

- FIFs maybe setup as a company, trust (contributory trust only) or limited liability partnerships or in any other form as permitted by the International Financial Services Centre ("IFSC").
- FIFs should maintain a minimum corpus of USD 10 million within a period of 3 years from the date of obtaining certificate of registration.
- FIFs could be an open ended or close ended scheme.
- FIFs may invest in the following:
  - securities issued by the unlisted entities / securities listed or to be listed or traded on stock exchanges in IFSC, India or foreign jurisdictions;
  - money market instruments / debt securities;
  - securitised debt instruments, which are either asset backed or mortgage-backed securities; and
  - derivatives including commodity derivatives / units of mutual funds and alternative investment funds in India and foreign jurisdiction
- FIFs are permitted to borrow funds and engage in leveraging activities

Prior to the commencement of activities of the FIF, all individuals of a single family who contribute to the FIF directly or indirectly shall give an undertaking to the concerned principal officer, to the effect that they understand the risks, costs and benefits associated with investing in the FIF and that the usual investor protection measures such as disclosures, regulatory inspection and supervision, etc., may not be available to the same extent to the FIF as they are to other schemes in IFSC.

Intent

High Net Worth families ("HNI") have been setting up family offices in cities such as Dubai, London, and Singapore, as these geographies offer business-friendly incentives, lower tax regimes, progressive regulation and unrestricted access to global markets. In India, the Liberalized Remittance Scheme ("LRS") or Overseas Direct Investment ("ODI") rules under Foreign Exchange Management Act ("FEMA"), 1999, are difficult to navigate, disincentivizing HNIs . However, with an aim to change the above scenario, the Government has permitted the establishment of an FIF in GIFT City, making India an attractive destination for the practice. The FM Regulations were released with a view to bolster the funding and capital ecosystem at the IFSC, the government provided for FIFs under the FM Regulations which are to be governed by the IFSC authority. They take cognizance of the problems faced by potential stakeholders and with a view to encourage more family office organisations to setup at IFSC.

Impact

An FIF set up in GIFT City will be considered to be an Indian resident for tax purposes and an overseas resident or offshore unit from a FEMA perspective. Any investments flowing from India into the FIF will be regulated by the provisions of FEMA and any onward investments by the FIF will be regulated by the FME Regulations. Some of the benefits that accrue from setting up a FIF in GIFT City are as follows:

- **Diversification of Investment in various Assets:** FIF can invest in (Un) listed securities, AIF, physical assets, in comparison to other routes
- **Leveraging of Banks in GIFT City:** It is allowed to take leverage in foreign currency from banks located in GIFT City
- **Maximization of LRS limit by Individual:** Investment can be pooled from family owned entities
- **Tax Concessions under both Income Tax and GST:** 100% Income Tax exemption for 10 years in SEZ subject to compliance and no GST will be applicable on services received by unit in GIFT City

4 Social Stock Exchange

Social stock exchange ("SSE") is a separate segment of the existing stock exchange, that can help social enterprise(s) to raise funds from the public through the stock exchange mechanism. SSE acts as a medium between social enterprises and fund providers. This enables them to select entities that create measurable social impact, and further report such impact. SEBI in 2022 notified a detailed framework on SSEs, which has been updated as of December 2023.

Intent

Currently, non-profit organisations ("NPOs") and for-profit social enterprises ("FPSEs") usually get funding from corporate social responsibility activities undertaken by entities, individual investors, Government funding or through loans from traditional banking channels. As India is heading towards target of becoming a 5 trillion-dollar economy, the available sources of funds may not be sufficient. Moreover, majorly large-scaled and renowned NPOs / FPSEs receive large amount of funding and small NPOs / FPSEs face financial crunch. Considering these aspects, an SSE can play a significant role in mobilizing funds for social and developmental activities. SSEs are trading platforms that allow social businesses and non-profits to raise capital by attracting ethical investors willing to invest in organisations that have a dual corporate and social mission. The objective of SSE is to bridge the financing gap by providing alternative fund-raising instruments for achieving socio-development goals.

Impact

SSE improves market access by facilitating a common and a structured meeting ground between social enterprises and investors / donors with inbuilt regulation for providing sanctity and accountability of finances. SSE also saves cost for both issuer and investor / donor by charging minimal fees for registration and listing. An Indian SSE has been set up in both National Stock Exchange ("NSE") and Bombay Stock Exchange ("BSE"). A capacity building fund ("CBF") housed under National Bank for Agriculture and Rural Development has been constituted to navigate the SSE and its processes, instruments etc. apart from creating awareness. The initial corpus of CBF to be deployed is INR 10 Crores.

The social enterprise shall be involved in at least one of the following activities:

- Eradicating hunger, poverty, malnutrition, and inequality
- Promoting health care including mental healthcare, sanitation and making available safe drinking water
- Promoting education, employability, and livelihoods
- Promoting gender equality, empowerment of women and LGBTQIA+ communities
- Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest, and wildlife conservation
- Protection of national heritage, art, and culture
- Training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports
- Supporting incubators of social enterprises
- Supporting other platforms that strengthen the non- profit ecosystem in fundraising and capacity building
- Promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector
- Slum area development, affordable housing and other interventions to build sustainable and resilient cities
- Disaster management, including relief, rehabilitation and reconstruction activities
- Promotion of financial inclusion
- Facilitating access to land and property assets for disadvantaged communities
- Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection; and
- Promoting welfare of migrants and displaced persons.

Key Considerations	Guidelines	Intent and Impact
Section 80G Registration for SSE	The NPO must be registered under Section 80G of the Income Tax Act	Entities that are registered under Section 80G of the Income Tax Act would have to undergo some checks to get the registration. This acts as an added layer of security to the mechanisms in place by SEBI. Entities may not be registered under Section 80G of the Income Tax Act (as a fund, charitable institutions, etc.) but are established or largely funded by Government. NPOs having registration certificate under Section 10(23C) (educational institutes) and section 10(46) of the Income Tax Act, 1961, may be considered as eligible for registration as NPOs with SSE.
"No Pending Notice Or Ongoing Scrutiny By Income Tax" Requirement For Registration On Sse	An NPO having pending notice or ongoing scrutiny by income tax authorities is ineligible for registration with SSE.	While disallowing entities having pending notice or ongoing scrutiny by income tax authorities from applying to the SSE may be considered to be prudent due to compliance concerns, it must be noted that many of the entities that register with the SSE are small NPOs and FPSEs. Such a threshold prevents the entry of smaller NPOs and FPSEs with inconsequential ongoing scrutiny of the income tax authorities from registering with the SSE.
Minimum Fund Flows of An NPO	The annual funding and spending of an NPO must be INR 10 lakhs and INR 50 lakhs, respectively, to be eligible to be registered on the SSE.	The higher threshold ensures the legitimacy of the entity to some extent. However, considering the fact that many entities registering with the SSE are not as established, it would be difficult for such entities to meet the high monetary threshold.
Zero Coupon Zero Principal Instrument ("ZCZP")	NPOs are allowed to raise funds through ZCZP. Whereas FPSEs are disallowed to raise funds using this instrument.	Instruments shall be issued without any coupon and no principal amount shall be payable on its maturity. These are similar to donations. These can only be issued by NPOs and helps supplement the high funding required by NPOs to create a significant social impact.
Minimum Issue Size For Npos And Minimum Application Size In Public Issue Of ZCZP	The threshold of the minimum issue size for NPOs issuing ZCZP is INR fifty lakhs and the threshold of minimum application size in public issue of ZCZP is INR 10,000.	Prior to the amendment of December 2023, the thresholds were extremely high, considering that the SSE is aimed at small social enterprises. A high minimum application size threshold would discourage a large number of investors from investing in or subscribing to ZCZP of multiple NPOs, resulting in lowering of the threshold.
Disclosure Requirements	To get listed on an SSE, companies must disclose their past social impacts. Companies listed on the SSE are required to disclose detailed information about their social and environmental performance.	Such disclosures help in ensuring that the social enterprises listed are genuinely committed to make a positive impact in the country apart from financial returns. It also allows investors to evaluate the impact of their investments. However, measuring social impact is complex and subjective. Presently, organizations must share the audit report prepared by social auditor stating the impact on target segment. Lack of uniform standards to measure the impact, which leads to concerns about the accuracy and comparability of impact metrics.

5 Fractional Investments

Fractional investing refers to the process of investing in a fractional portion of a security, a concept that is prevalent in India in the real estate sector. SEBI in its board meeting in November 2023, gave their in-principle approval to Small & Medium REITs ("SM REITs") in the form of amendments to the SEBI (Real Estate Investment Trusts) Regulations, 2014 so as to create a regulatory framework for SM REITs. Per the amendment, such REITs can have an asset value of at least INR 50 crore, as opposed to the current minimum asset value of INR 500 crore for other existing REITs.

The Regulatory Framework for Micro, Small and Medium REITs ("MSM REITs") dated May 12, 2023 aims at regulating platforms offering fractional ownership of real estate assets. Such fractional ownership of real estate assets is proposed to be brought as MSM REITs under the SEBI (Real Estate Investment Trusts) Regulations, 2014 ("REIT Regulations").

Intent

The Regulatory Framework for MSM REITs attempts to lay down the features of Fractional Ownership Platforms ("FOPs"). In light of the increasing value of investments with FOPs, such a regulatory framework can prove to be instrumental in requiring registration and regulation of such FOPs. This will in turn ensure uniform standard disclosure practices, regulatory oversight, investor redressal mechanism, etc. in order to protect the investors' interests.

Impact

The introduction of fractional ownership in real estate offers an opportunity for those interested in investing in and willing to offer smaller-sized REITs. As such formal recognition by the SEBI comes in the wake of it taking note of the rising number of unregulated web-based platforms offering fractional ownership, a formal recognition allows the market to develop as well as offers investor protection.

6 Investments in AIFs

The RBI has, in a bid to regulate the evergreening of loan exposures in the form of AIF investments released a circular dated December 19, 2023.

The regulation prevents regulated entities ("RE") from making investments in any AIF scheme which has downstream investments investment in any such debtor company. The RE shall liquidate its investment in the scheme within 30 days from the date of such downstream investment by the AIF, otherwise they shall make a 100% provision on such investments. In addition, investment by REs in the subordinated units of any AIF scheme with a 'priority distribution model' shall be subject to full deduction from RE's capital funds. It is pertinent to note that the guidelines do not apply if another scheme of the same AIF or any scheme of an AIF which has the same investment manager, invests in a debtor company of such an RE. Further, as per the definition of debtor company of the RE, if RE invests in an AIF and then AIF has makes an downstream investment in the company (start-up) and later on post the above transactions, if RE sanctions/disburses the loans/investment to the company, then RE may not be required to create a provision or liquidate their investments i.e. downstream investment by AIF; given that all drawdowns are already called for from the RE by AIF.

Intent

It came to the light of RBI that there are certain transactions which entailed substitution of direct loan exposure of REs to borrowers, with indirect exposure through investments in units of AIFs. The circular intends to curb window dressing of loan books and evergreening efforts by a few lenders.

Impact

Start-ups in the lending space would be adversely impacted by this circular as they may be constrained by the existing AIFs to not take debt from REs who have invested in them. This might also impact the AIF's ability to raise funds from REs. Further, AIFs of large REs may be more severely affected.' Furthermore, it is not easy to sell the AIF units as these are neither listed nor there is a readily available market to offload them.

> Several industry bodies have made representations against the circular and we might see amendments or more clarifications soon.

**Debtor company of the RE, for this purpose, shall mean any company to which the RE currently has or previously had a loan or investment exposure anytime during the preceding 12 months.*

7 AIFs & AMCs - Other Key Updates

Key Considerations	Guidelines	Intent and Impact
Distribution of Fees to Wealth Management Firms	Distribution fee with respect to distributors needs to be disclosed to the investors. • CAT-I and CAT-II AIF funds can pay up to 33% of the distribution fee/ placement fee upfront and balance needs to be paid on equal trail basis over the fund tenor • CAT-III AIF funds require to pay distribution fee/placement fee on an equal trail basis over the fund tenor	Provides transparency to the investors on the fees paid to their distributors. It will impact the yearly revenue of the distributors
Demat Securities for Start-Up Securities	AIFs must issue units in demat form. Schemes of AIFs with corpus more than or equal to INR 500 crore are required to: • Dematerialise all the issued units by October 31, 2023; and • Begin issuing dematerialised units from November 1, 2023. Schemes of AIFs with corpus less than INR 500 crore are required to: • Dematerialise all the issued units by April 30, 2024; and • Begin issuing dematerialised units from May 1, 2023. However, units of AIFs need not be dematerialised for schemes whose tenure ends on or before April 30, 2024.	SEBI has mandated dematerialisation of units owing to the efficiency, convenience and ease of record-keeping it offers Systems must be put in place for facilitating transfer of AIF units in demat form. Appropriate approvals from the AIF / manager of AIF must be taken.
Amendments to the Asset Management Companies Framework	The amendment, amongst other things, introduces alternate eligibility criteria that allows non-financial services entities and "a private equity fund or a pooled investment vehicle or a pooled investment fund", to become sponsors, subject to, • Capital infusion of INR 150 crore into the AMC • Shareholding equivalent to the initial capitalisation of INR 150 crore to be locked-in for a period of 5 years; • Appointment of experienced senior management officials, having a combined experience of at least 30 years; and • In cases of acquisition of an existing AMC, maintaining liquid net worth equal to the incremental capitalisation to bring the net worth of the AMC to INR 150 crore. The amendment also provides a framework for 'existing' sponsors to "disassociate" from an AMC, basis conditions to be prescribed by SEBI, and subject to, • AMC having diversified shareholding (no single shareholder with more than 10% shareholding); and • AMC having 2/3rd independent board of directors (as opposed to the 50% independent board of directors for AMCs with a sponsor).	With respect to AMCs, the Amendment replicates many monitoring and investor protection responsibilities for the board of directors of the AMC, in addition to the trustees.

Banking

Recent Developments in Digital Banking

1 Green Deposits

Green deposits are deposits for investing in "green" projects. The RBI has recently released a framework for green deposits in India, and aims at aiding customers to achieve their need for sustainability and preventing instances of greenwashing.

Intent

The availability of finance for sustainability has an important role to play in mitigating climate change. To this effect, RBI also conducted a survey in January 2022 to assess the status of climate risk and sustainable finance in leading scheduled commercial banks, and observed a need for concerted effort and further action in this regard On 11th April, 2023, RBI released the Framework for Acceptance of Green Deposits ("Framework") for banks and deposit-taking NBFCs/ HFCs, to be applicable from 1st June, 2023.

Impact

The framework will help the green finance ecosystem in India. REs will benefit from the clarity provided in terms of the various aspects of green deposits, their allocation, monitoring, reporting, and disclosures. There is a growing preference for ESG rated products and green deposits could be a good fit for investors seeking such options. With sufficient checks and balances investors looking for green deposits can be assured that their money is being spent for the intended purpose. Greenwashing concerns will be addressed by green taxonomy, reporting, third party validation, and disclosures by REs.

The provided guidelines aim to assist banks in formulating strategies for their future endeavors in cultivating environmentally friendly portfolios. These green deposits will serve as a funding source, enabling banks to provide loans for projects aligned with the United Nations Sustainable Development Goals.

This will empower businesses to play a role in societal and economic well-being by actively participating in the mitigation of climate change risks. Green deposits offer an avenue for indiv

Key Considerations	Guidelines	Intent & Impact
Overview	REs will be required to allocate the proceeds raised through green deposits towards projects that encourage energy efficiency in resource utilization, reduce carbon emissions and greenhouse gases, promote climate resilience and/or adaptation, and improve natural ecosystems and biodiversity. The following projects have been excluded from green financing: new or existing extraction, production and distribution of fossil fuels, including improvements and upgrades, nuclear power, direct waste incineration, alcohol, weapons, tobacco, gaming, or palm oil industries, renewable energy projects generating energy from biomass using feedstock originating from protected areas, landfill projects and hydropower plants larger than 25 MW.	The goal is to extend loans for projects that support the United Nations Sustainable Development Goals. In short, the scheme aims to augment the flow of credit towards green projects/ activities. Green Deposit offers an avenue to people who wish to see their money being invested for environmentally friendly reasons. Boosts opportunities especially for climate financing focused start-ups to attract funds from banks at a decent rate of lending. Challenges: • Depositors have no compelling reason to switch to green deposits as interest rates are lower or par with fixed deposit offering. ALM mismatch: • There seems to be asset liability mismatch scenario as generally deposits are for 3-5 years tenure and the large-scale green projects generally last for more than 10 years at a time. • Yearly audits including but not limited to third-party verification of the end use of funds. High amounts of compliance and transaction load.
Framework	REs must put in place a board-approved financing framework.	To ensure that REs abide by the guidelines of the board-approved financing framework. A comprehensive financing framework shall provide better guidance to REs on decisions to be made regarding green financing.
Compliance	Allocation of funds raised through green deposits by REs during a financial year shall be subject to an annual independent third-party verification / assurance.	The requirement for transparency and neutrality was realised, with the understanding that REs should not make biased decisions affecting the stakeholders negatively. Such third-party verification will ensure neutrality and transparency.

2 Outsourcing of Information Technology

The RBI Master Direction on Outsourcing of Information Technology provides guidelines for service providers engaged by regulated entities ("REs"). These service providers provide IT services to REs, and include services such as cloud computing services, IT infrastructure management and maintenance, management of IT infrastructure and technology services associated with payment system ecosystem etc.

Previously, outsourcing of IT activities was loosely guided by the outsourcing norms applicable for banks and NBFCs for outsourcing financial services. RBI acknowledged that the challenges offered for outsourcing of IT services differs from the challenges offered for outsourcing of Financial services. As a result, separate guidelines were issued specifically for outsourcing IT services. The guideline encapsulates checks and balances for REs on how they can interact with service providers.

Key Considerations	Guidelines	Intent & Impact
Segregation of Data	If a service provider acts as an agent for multiple REs, adequate systems / measures must be put in place to ensure that the information, assets etc. of each RE do not combine.	To ensure confidentiality and security of data, segregation of data has been mandated if a service provider acts as an agent for multiple REs. REs must ensure that the service providers engaged by the RE use appropriate technology and take appropriate steps to ensure that such segregation is possible.
Group Entity	If the service provider is a group entity of the RE, REs must maintain an arms' length relationship in dealing with such a service provider.	Ensuring that undue advantage / relaxation to any particular service provider is not given to any service providers. Any relaxations given to service providers may negatively impact the customers of the REs. This helps in protecting the rights of the customers. Greater transparency and provides a level playing field.
Responsibility of REs	REs are ultimately responsible for ensuring that the service providers have taken appropriate measures in delivering its services. The RE and the service provider must be bound by a contract, wherein the obligations of each party must be clearly enunciated.	Service providers are not regulated by the RBI. Therefore, it is ultimately the responsibility of the RE to ensure that appropriate measures are taken by service providers while they offer their services to REs in line with the IT Outsourcing norms. REs cannot abdicate their responsibilities, even if the ultimate IT activity is being outsourced to a third party. REs are likely to undertake due and proper precautions while choosing the service providers to engage.
Cross-Border Outsourcing	In cases of cross-border outsourcing, REs must take particular care in ensuring that the policies of the foreign jurisdiction of the service provider are closely monitored. Further, REs must ensure that the service providers continue to make records of available to the RE and RBI in the event the service provider goes into liquidation.	Outsourcing activities to service providers expose the RE to country risk. To manage such risks, the RBI has mandated due care and diligence must be taken—including analysing the political, social, legal, and economic conditions of such foreign jurisdictions. It should also be read along with DPDP Act, 2023. Mitigates risks associated with cross-border outsourcing.

3 Outsourcing of Financial Services

The Reserve Bank of India ("RBI"), on October 26, 2023, issued the draft Master Direction on Managing Risks and Code of Conduct in Outsourcing of Financial Services ("Draft MD"). The Draft MD is applicable to commercial banks, all India financial institutions, all non-banking financial companies including housing finance companies, urban co-operative banks, state co-operative banks, central co-operative banks and credit information companies (collectively, "RE"). The Draft MD however, in line with earlier iterations, is not applicable to technology-related aspects, or activities not directly related to banking or financial services such as courier, catering, janitorial and security services.

Intent & Impact

Streamlining of regulations: The Draft MD incorporates, updates and harmonizes the three extant guidelines and directions on outsourcing of financial services by banks (November 3, 2006), co-operative banks (June 28, 2021) and non-banking financial companies ("NBFC") (October 22, 2021) [issued as part of the scale-based regulatory framework for NBFCs ("NBFC Scale-Based Regulatory Framework"). This was a revision of the November 9, 2017 directions on outsourcing of financial services by NBFCs]. A consonant regulatory front (collectively, the "Extant Guidelines") is beneficial to both regulators and industry players.

Liability for sub-contracted activities: A marked departure from the Extant Guidelines is the inclusion of subcontracted activities within the scope of liability for REs, to which the Draft MD will apply. This is a timely intervention, considering that subcontracting may enable circumventing RE liability, which is now rendered a more difficult task due to regulation.

Group outsourcing: While the NBFC Scale-Based Regulatory Framework allowed for outsourcing of core management functions within a group, the Draft MD, which is applicable to all types of REs does not allow for any core functions to be outsourced, even to group entities that are compliant with the Extant Guidelines.

Outsourcing agreements: The Draft MD lists down various clauses that must be mandatorily present in the agreements between REs and the service providers to ensure flexibility, accord responsibilities, ensure customer confidentiality.

There are however, growing concerns as a result of the new guidelines, related primarily to group outsourcing, sub-contracting, off-shore outsourcing and obligations under the new Digital Personal Data Protection Act;

No relaxation for group outsourcing of core functions: The NBFC Scale-Based Regulatory Framework previously allowed for core management functions to be outsourced, within a group subject to certain requirements, such as having Board-approved policies and undertaking arms-length transactions. However, under the new Draft MD, the possibility of such outsourcing is barred. Group entities with specific resources or expertise could possibly better undertake such functions that lend themselves towards outsourcing, but are now prohibited from doing so under the new Draft MD.

Potential issues with sub-contracting: The Draft MD applies to subcontracted activities and 'sub-contractors' have also been included in the definition of "service provider". This could prove difficult for REs to ensure compliance with subcontracting, as their capacity to contractually enforce the new Draft MD would be limited to a certain level of subcontracting. A risk-based approach where the RE's prior approval for material outsourcing to sub-contractors, similar to that which is envisaged in the outsourcing guidelines of the Monetary Authority of Singapore and the Hong Kong Monetary Authority, may be regarded in this context.

Difficulties in off-shore outsourcing: The Draft MD clarifies that in situations involving a conflict of laws, the guidelines of the host country of the overseas service provider would prevail. However, it is also the RE's responsibility to ensure that a host regulator cannot extend its jurisdiction for inspection, data access, or other functions of this nature extraterritorially to Indian operations. If the host country regulations are to prevail, REs will not be able to avoid the extraterritorial application of such regulations. This ambiguity could lead to difficulties in compliance. It is recommend that regulators work with industry players to find a better approach, so that REs can ensure a minimum threshold of compliance with the local requirements while adhering to host country guidelines.

Reactions with DPDP Act Obligations: Under the Digital Personal Data Protection Act, 2023 ("DPDP Act"), REs outsourcing financial services that involve any processing related to personal data will be considered 'data fiduciaries' while service partners will be 'data processors'. Apart from existing audit and operational risk assessments under RBI guidelines, REs will be responsible for the procurement of all relevant consents from data principals, and ensure compliance on the part of data processors. In addition to the additional compliance burden and costs, unless the rules under the DPDP Act provide any carve-outs, REs will remain liable for any breaches by outsourcing partners even if reasonable measures have been taken by the REs.

In summation, through the Draft MD, the RBI has consolidated guidelines on outsourcing of financial services and has appeared to move from an entity-based regulatory framework to an activity-based one. Accordingly, financial service outsourcing presents a significant risk which requires REs to carefully approach the regulatory difference by re-evaluating their existing arrangements and service contracts once the Draft MD is finalised. However, there are significant concerns arising out of the Draft MD that need to be addressed to ensure business continuity and avoid service disruptions across the financial services industry.

Insurance

❶ Surety Bonds

Surety insurance contract is a contract of guarantee under section 126 of the Indian Contract Act 1872. It is a contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is the "surety"; the person in respect of whose default the guarantee is given is the "principal debtor", and the person to whom the guarantee is given is the "creditor". Surety bonds are legally enforceable tripartite contracts that guarantee performance and/or payment and can be used as a substitute for Bank Guarantees. They are generally used to guarantee the performance of a contractor, supplier, or other party in a business transaction.

Indian market players, specifically those in the projects/construction sector have been seeking inclusion of surety contracts under insurance. Earlier, parties had to avail either bank guarantees (which involved certain collateralisation and commissions) or surety insurance offered by overseas insurance companies, that called for separate regulatory approvals in India.

Guidelines

According to the guidelines,

- The premium charged for all surety insurance policies underwritten in a financial year, including all installments due in subsequent years for those policies, should not exceed 10% of the total gross written premium of that year, subject to a maximum of INR 500 crore.
- Insurers can issue contract bonds, which assure the public entity, developers, subcontractors, and suppliers that the contractor will fulfill its contractual obligation when undertaking the project.
- Contract bonds may include Bid Bonds, Performance Bonds, Advance Payment Bonds, customs and court bonds, and Retention Money.
- Meeting the requirement of maintaining a solvency margin of not below control level of solvency specified by IRDAI (i.e., 1.5 times).
- Surety Insurance contracts should be issued only to specific projects and not clubbed for multiple projects.

Intent

The IRDAI released the IRDAI (Surety Insurance Contracts) Guidelines, 2022 in response to growing industry demand. Such guidelines will enable liquidity of contractors and largely benefit the infrastructure sector. While a few reports suggest that the new Surety Insurance Guidelines have been positively received, high incidence of defaults by contractors in India and relatively slow recovery mechanisms are expected by few stakeholders that may continue to remain roadblocks in the implementation of such surety products.

Impact

Surety bonds serve as a vital risk management tool for economic growth as well as contract enforcement mechanism with an aim to reduce the dependence on infra developers of bank guarantees. The absence of regulatory measures in the area of surety bonds made it difficult for insurance companies to offer surety bonds. Amendments such as a drop in solvency margin and removal of guarantee limit have provided a much needed impetus to insurance companies to issue surety bonds. Insurers are now becoming competitors to banks, which offer bank gurantees for such projects.

2 Composite License

A composite license allows insurance companies to sell and process life and non-life insurance products without having separate licenses in each insurance segment. At present, India does not allow a single entity to sell life and non-life insurance products. However, both IRDAI and the Ministry of Finance ("MoF") have proposed the issuance of a composite license. However, an entity which seeks registration to undertake reinsurance business is ineligible to seek registration of any other class or sub-class of insurance business.

Intent

The implementation of the Insurance Law (Amendment Bill) 2023 is a step in this direction and will result in opening up registration to various classes, sub-classes, and types of insurers, thereby permitting composite, stand-alone or other types of insurers to seek a license. A composite license would mean an insurer can offer both life cover and the whole/any part of non-life insurance like motor or health insurance.

An amendment has been proposed by the Department of Financial Services, Ministry of Finance, to Section 3 of the Insurance Act, 1938. Pursuant to the notification of the proposed amendment, an application for registration by any category or type of insurer may be made for various classes or sub-classes of the insurance business. Therefore, a single insurance company (provided that such an insurance company is not undertaking a re-insurance business) may undertake multiple classes/ sub-classes of insurance business. The requirements mentioned under Section 2C, 3AA, 5, 6 and 31 A (pursuant to the proposed amendment) must be fulfilled. These refer to eligibility criteria, the capital requirements and the management of the entity. Inclusion of these provisions in the Insurance Act, 1938, would enable customers to seek various insurances (such as general, health and life insurances) from the same insurer. This would help in the faster and easier penetration of insurance in the Indian market.

Currently, IRDAI has prohibited life insurers from undertaking the business of general insurance (and vice versa) to ensure (i) the safety of the funds of the policy holders, by disallowing the same entity from holding licences for both life and general insurance; and (ii) separation of risk to the funds of the policy holders. The proposed amendment also provides for a separation of the accounts for life insurance business and general insurance business, thereby ensuring integrity of financials.

Impact

The flexibility associated with composite license will expand the options available to policyholders and promote comprehensive coverage. If the proposal for composite insurance registration is passed, there would be a change in solvency margin and capital requirement for these companies. The overall sector product risk diversification will improve for composite insurers.

A composite license from the regulator will enable the entity to do multiple lines of businesses, without the need for separate infrastructure. This will also allow consumers access to a variety of products under one roof.

3 Managing General Agencies

A managing general agent ("MGA") or a managing general underwriter is an insurance agent who has been vested with underwriting authority from an insurer and can carry out other functions such as administration of programs and negotiation of contracts for an insurer. Activities on behalf of the insurer may include marketing, underwriting, issuing policies, collecting premiums, appointing and supervising other agents, paying claims, and negotiating reinsurance.

Guidelines

While such entities do not exist in India, they are popular models in the US and Singapore. However, subsequent to conversations with founders of large insurance intermediaries, the Insurance Regulatory and Development Authority of India ("IRDAI") is thought to be receptive to the idea of MGAs. Insurtech start- ups which mostly operate as insurance intermediaries are pushing for a new set of licenses from the IRDAI to set up agencies who can source customers and take risks as well.

In October 2021, the International Financial Services Centres Authority ("IFSCA") notified the IFSCA (Registration of Insurance Business) Regulations, 2021 ("IIO Regulations") superseding the IRDAI IIO Guidelines. The IIO Regulations provide for eligibility criteria, the process of application for registration, permissible activities by an IIO and other incidental matters. The IIO Regulations permit managing general agents having a binding agreement with a foreign insurer/reinsurer to apply for IFSC Insurance Offices ("IIO").

Intent & Impact

MGA forms an important part of the insurance distribution chain. In the banking space, an MGA is similar to an NBFC. An MGA can onboard customers, manage products, underwrite customers and also share the risk with larger insurance manufacturers.

As a managing general agent in the Indian insurance market, one can fill the gap in the current distribution setup by leveraging expertise and resources in a particular line of business to offer customized insurance solutions to customers that are not easily accessible through traditional distribution channels. There is the opportunity to fill the gap in the current insurance distribution setup by offering specialized insurance products, expanding distribution channels, using technology to improve the customer experience, offering value-added services, and focusing on customer education.

Global Comparison

A United States of America

The National Association of Insurance Commissioners ("NAIC") has adopted the Managing General Agents Act (#225) to guide the states in regulating MGAs.

Definition

Per Section 2 of Model #225, a managing general agent means any person who: (1) Manages all or part of the insurance business of an insurer (including the management of a separate division, department or underwriting office); and (2) Acts as an agent for such insurer whether known as a managing general agent, manager or other similar term, who, with or without the authority, either separately or together with affiliates, produces, directly or indirectly, and underwrites an amount of gross direct written premium equal to or more than 5% of the policyholder surplus as reported in the last annual statement of the insurer in any one quarter or year together with the following activity related to the business produced adjusts or pays claims in excess of $10,000 per claim or negotiates reinsurance on behalf of the insurer.

Regulatory Requirement

In most states, MGAs must be licensed as producers and are not allowed to place business until a written contract exists among all parties. Under Model #225, insurers are required to monitor the financial stability of MGAs under contract.

Net worth criteria

While no net worth criteria has been mandated for MGAs, the insurer of the MGA must have on file an independent audited annual financial statement / reports showing that the MGA has had a positive net worth for the 2 most recent fiscal years.

Bearing Risk

The industry practice is to have risk-based parameters under which only can the MGA operate.
Moreover, there is also a practice of risk-related performance bonuses within the agreements.

Settlement of Claims

The NCIA Managing General Agents Model Act permits the MGA to settle claims on behalf of the insurer if a contract exists for the same. However, it provides for certain mandatory provisions to be present in the MGA agreement where obligations inter alia timely reporting, reporting of limit-exceeding claims, scope for termination are present.

Permitted Activities

The NCIA Managing General Agents Model Act in the definition of "MGA" states that employee of the insurer; U.S. Manager of the United States branch of an alien insurer; An underwriting manager which, pursuant to contract, manages all or part of the insurance operations of the insurer, is under common control; the attorney-in-fact authorized by subscribers of a reciprocal insurer will not be considered MGAs.

B United Kingdom

The Managing General Agents' Association ("MGAA") is a not-for-profit organisation for representing managing general agents. It has evolved into a trade association that delivers real value to MGAs who currently write in excess of £6 billion GWP worldwide and are dedicated to shaping the landscape of delegated underwriting in the UK and Republic of Ireland.

Definition

The MGAA defines a managing general agent as an agency whose primary function and focus is the provision of underwriting services and whose primary fiduciary duty is to its Insurer principal. Such MGAs provide certain services such as underwriting services, distribution and servicing of customers.

MGA business will undertake all the functions and services customers in the same way an insurer would; but with the one crucial difference they do not bear risk nor manage regulated capital.

Regulatory Requirement

It is widely assumed that the conduct of intermediated insurance business is always regulated under the Financial Services & Markets Act, 2000 ("FSMA"). However, not all insurance business is regulated business.
There are two methods of undertaking regulated MGA business in the UK:

1. Direct Authorisation – this process can take up to 6 months, requires detailed business plans and the provision of much information to be submitted to the Financial Conduct Authority ("FCA") in respect of business controls, Board composition, systems, professional indemnity insurance and the business process.
2. Acting as an Appointed Representative – here, an already regulated intermediary (the "Principal" which may be a broking house) effectively supports the start-up MGA business taking on all the regulatory responsibility and liability from day one. The process of appointment and approval by the regulator takes little time, and the costs are considerably less.

Net Worth Criteria

The FCA has prescribed requirements for the amount of capital that an authorised Principal must be maintain, both in respect of its own business and that of its AR. If it holds client monies, then 5% of its turnover is required. If it holds monies by way of 'risk transfer', then 2.5% of its turnover is required.

Bearing Risk

The industry trend is not assuming risk, but MGAs often do contract for risk.

Settlement of Claims

The Regulated Activities Order defines a "managing agent" which includes an individual paying claims on insurance contracts.

Insurance - Other Key Updates

Key considerations	Guidelines	Before	After	Intent & Impact
Surety Bonds	The cap of 30% on the limit of guarantee has been omitted.	Limit of guarantee restricted to 30% of the contract value. Meeting the requirement of maintaining a solvency margin of not below 1.25 times of the control level of solvency specified by IRDAI (i.,e. 1.875 times).	No cap on the limit of the guarantee. Meeting the requirement of maintaining a solvency margin of not below control level of solvency specified by IRDAI. (i.e., 1.5 times).	The changes are aimed at expanding the surety insurance market by increasing the availability of such products.
Expense of Management—Intermediary Commission	The cap on payment of commission to insurance agents and intermediaries has been removed.	Payment of commission to insurance agents and intermediaries was restricted to a particular amount. This amount was determined by the products being offered.	The insurance regulator has replaced the earlier individual cap on commission payments on insurance products with an overall cap on expenses of managaement of insurers. The segmental limits on commissions will be removed and the fees paid to intermediaries, such as individual agents, corporate agents, etc., will be based on the expense of management (EoM) limit. For insurers carrying on general insurance business, the EOM limit is up to 30% of the gross premium written in India in a financial year and up to 35% for insurers carrying on health insurance business. The EOM Regulations also allow an insurer to incur certain "additional allowable expenses" over and above the EOM limit, which include: head office expenses; "insurtech expenses" and "insurance awareness" expenses; and expenses incurred towards the rural sector including certain government and other schemes as notified by the IRDAI.	It will provide greater flexibility to insurers in managing their expenses. We envisage distribution - led business models would likely attract more investments.

Key considerations	Guidelines	Before	After	Intent & Impact
Corporate Agents	Corporate agents may have arrangements with a maximum of nine life and non life insurers to solicit, procure and service their insurance products.	Corporate agents may have arrangements with a maximum of three life, health and general insurers to solicit, procure and service their insurance products.	The maximum number of insurers a corporate agent is allowed to have arrangements with has been increased to nine insurers i.e 9 life, 9 health and 9 general insurers.	Corporate Agents will be able to offer more competitive and bouquet of products to its customers.
Use and File	Key responsibilties are as follows: • Form board-approved policy for products that are to be filed, modified or revised. • Ensure the viability of product pricing, self sustainability and affordability for the targeted market after the approval from the Product Management Committee (PMC). • File documents, as per Para 22 with the Authority, through an online platform (currently BAP), to generate the UIN. • Launch the product within 15 days from the date of generation of UIN with an intimation to the Authority. • File the product within seven days of launch. • Revise prices (if any) basis the underlying claims experience (Incurred Claims Ratio) to make the product viable and self-sustainable. • Act in a responsible manner and if an insurer is found to be non compliant with the extant regulations or guidelines, the Authority, notwithstanding the action that may be taken under the provisions of Insurance Act 1938, may take one or more of the following actions: –Direct the insurer to withdraw the product. –Withdraw the use and file facility as per the norms specified herein for such an insurer for a period as may be determined.	Insurance companies followed the file and use procedure, where they filed the products with IRDAI and respond to queries raised by the Regulator if any. The companies could launch the products after the necessary approvals were given. It was mandatory for the insurance companies to take prior approval before launching any life insurance product. All types of products can be filed under this procedure.	With the introduction of the use and file process, the insurers can introduce their products to the market on filing with the regulator, thus avoiding a long waiting duration to get approvals for their products. All the health insurance products, almost all general insurance products under fire, motor, marine and engineering and life insurance products (except individual savings, pensions and annuity) can be filed under this procedure.	To increase the growth and penetration of insurance. This will enable insurance companies to bring out innovative products to the market at a faster frequency as compared earlier where approvals usually take a couple of months. This will entail in ease of doing business and will allow insurers to introduce customised products for different customer segments, further inducing the reach in untapped geographies.

Payments

1 Card Regulations

With the rise in digital transactions enabling cashless payments and the convenience it offers to customers, rapid development has taken place in the card-sector—technologically, and, consequently, legally. The RBI has clamped down on cards specifically, realising the need for comprehensive laws to deal with the same and to ensure seamless digital payments in the country. The following concepts have been recognized through the form of regulations by the RBI.

A Prepaid Instruments

Prepaid Instruments (PPIs) are instruments with stored value stored that facilitate the purchase of goods and services and enable remittance. RBI's Master Direction on PPI provides guidelines for PPI issuers, such as banks and non-banks, to operate payment systems for issuing PPIs.

Key Considerations	Guidelines	Intent & Impact
Centralised Payment System ("CPS")	PPI issuers are allowed to participate in CPS (NEFT and RTGS) as direct members. An overall limit of INR 2,00,000 has been set.	Such a move encourages non-bank participants to operate in the payment sphere. It enhances accessibility of payments infrastructure and provides avenues for reducing intermediaries and minimizes settlement risks It also ensures interoperability of PPI wallets, digital transactions in the country, and ensures a digital trail of individuals involved in digital transaction.
Credit Lines	Previously, non-bank issuing PPIs tied up with NBFCs and banks to issue PPIs. Consequently, the NBFC would load such PPIs with a "credit line"—as a result, PPIs essentially functioned as credit cards. Currently, the RBI has disallowed PPIs from being used as credit instruments.	Such "shadow credit cards" do not comply with the regulatory framework for credit cards. There were concerns over such unsecured credit lines due to the risk of fraud and lack of comprehensive customer grievance redressal mechanisms. However, this limits the functionality of PPIs, particularly in the BNPL segment. Companies may now provide loan into a bank account and link the bank account with the customer's PPI.
PPI & UPI	Companies without a PPI license cannot offer UPI services through co-branding arrangements with bank and non-bank PPI license holders.	Companies require to obtain a PPI license in order to offer UPI services. However, the tedious process of applying for a PPI license as well as developing the entire stack can discourage companies from offering PPIs.
Cross - Border	The transaction limit for both cross-border outward and inward remittance has been limited to INR 50,000 per month and INR 10,000 per transaction However, only full-KYC PPIs can be used for making cross-border payments.	Provides more flexibility with respect to using PPIs for making payments.

B Card Tokenisation

Guidelines

Card Tokenisation refers to the replacement of actual card details with an alternate code called the "token", which shall be unique for a combination of card, token requestor (i.e. the entity which accepts request from the customer for tokenisation of a card and passes it on to the card network to issue a corresponding token) and device (referred hereafter as "identified device") Explicit consent of the customer is required for tokenising card data, requiring additional factor of authentication. Card tokenisation services can be offered by an authorised card network or by the card issuer, and only they can store actual data of the card. Entities in the payment chain, including merchants, may only store limited data, such as the last four digits of the card.

Intent & Impact

In the digital age, the banking and financial industry has witnessed an unprecedented transformation, leveraging technology to streamline operations and enhance customer experience. However, this transition comes with its own set of challenges, one of which is the alarming rise of data leaks and breaches. The need for tokenization was necessitated by frequent leaking of card and other sensitive details on dark web. Unlike encryption, which yields an identical output when the same data is encrypted with the same key, tokenization creates a unique token for each instance of data, even if the data is identical. This feature reduces the risk of pattern recognition in the data, providing an additional layer of security. Tokenization is thus, a one-way process that cannot be reversed to the original data. Currently, however, it is applicable only on domestic transactions.

The RBI introduced Card-on-File Tokenisation ("CoFT") in 2021 and its implementation began in the following year. Since then, there have been timely updates to ensure seamless tokenization such as introducing new channels for the process. For instance, as of December 2023, tokenization can now be undertaken at the bank-level itself.

Payment aggregator and merchants onboarded by them require processing payments without storing card details, irrespective of whether they are in compliance with PCI-DSS. However, difficulty in identifying issuers of card and card type may affect user experience, particularly with respect to refunds and replacements, which could act as deterrent for opting for cards as a payment option.

C Co-Branding Arrangements

"Co-branding" refers to arrangements between a bank or an NBFC and a non-banking entity, where the non-banking entity can only engage in marketing and distribution of cards. NBFCs registered with the RBI may issue co-branded credit cards without prior approval of the RBI. The non-banking entity is usually a customer-facing brand, such as an airline, an e-commerce platform or a retail chain. Such a partner is now allowed access to information on the transaction. Apart from being the initial point of contact in cases of grievances, the partner cannot be involved in any of the processes or controls relating to co-branded cards. Co-branding, of late, has also been seen with PPI instruments.

Intent & Impact

Co-branding allows banks and NBFCs the opportunity to tap into a loyal customer base of the co-branding partner. By associating the financial institution with a well-known consumer brand, it allows for more visibility. Thus, as a marketing arrangement this proves to be successful. Customers are encouraged to use cards to utilize the discounts, rewards, benefits offered by the exclusive card.

D Card Network Portability

Guidelines

Card network portability in India refers to the ability of customers to switch between different card networks such as Visa, Mastercard and RuPay, without having to change their underlying bank account. This aims to enhance competition and innovation among card issuers and allowing customers the freedom of choosing their service providers. The RBI has floated a draft circular in 2023 for its implementation.

Intent & Impact

A card network portability system would make the arrangement more consumer-centric while aiming for financial inclusion. Due to the competition this could foster, it can be said that this could lead to greater innovation among card issuers. RBI has been, of late, attempting to make the payment system self-reliant, as reliance on international service providers makes the system vulnerable to geopolitics. The option of portability can also be seen as one such move, as it encourages the use of RuPay while propelling it to a level-playing field amongst the bigger international players, i.e., Visa and Mastercard.

❷ Payment Aggregators and Payment Gateways

In the Payment Aggregators space, the RBI has taken significant efforts to bolster transparency and keep the space regulated and supervised. The RBI has taken a cautionary approach while granting payment aggregator licenses to entities applying for the same. While the guidelines regulating payment aggregators and payment gateways were rolled out in 2020, the RBI began granting final approvals to entities and only as recently as December 2023 were certain PAs granted licenses.

Payment Aggregators

Payment Aggregators ("PA") are entities that receive payments from customers, pool and transfer them on to the merchants after a time period. As an intermediary, PAs facilitate e-commerce sites and merchants to receive payments from customers through various payment instruments, thus eliminating the need for the merchant to create a separate payment system of their own.

Ⓐ Payment Aggregators

Key Considerations	Guidelines	Intent and Impact
Capital Requirement	Payment aggregators applying to the RBI for attaining license to operate as a payment aggregator must have a minimum net-worth of INR 15 crore and must attain a net worth of INR 25 crore by the end of third financial year of grant of authorisation. This net-worth must be always maintained thereafter.	The high capital requirement for payment aggregators stems from the crucial role played by payment aggregators in enabling payments for e-commerce entities. Therefore, there arises a requirement for ensuring that the payment aggregators have enough financial resources to manage risks, absorb losses and provide uninterrupted services. This ensures that only certain players may enter the payment aggregator industry, with the assurance that they are unlikely to face major financial crisis that may wind up their business.
Fit and Proper	The promoters and directors of the applicant Payment Aggregator must satisfy the 'fit and proper' criteria as prescribed by the RBI, which shall further be analysed by the RBI by itself and / or basis inputs from other regulators, government department etc. Applications may be returned if the eligibility criteria are not met / incomplete.	The 'fit and proper' criteria intend to ensure that the promoters have the capability of ensuring that they have the necessary resources, integrity, and suitability to promote the payment aggregators. This ensures that payment aggregators with unsuitable promoters are automatically disqualified from registering as payment aggregators with the RBI, and only those applicants with sufficient support from promoters remain in the industry.

Key Considerations	Guidelines	Intent and Impact
Restrictions on changes	In the event of any takeover / acquisition of control / change in management on a non- bank payment aggregator, an intimation must be made to the RBI with certain information. The RBI may place restrictions on such changes, if required.	As incidents involving takeovers / acquisition of control / changes in management have the potential of negatively affecting payment aggregators, the RBI's insistence on placing requisite restrictions with respect to the such events shall help in curtailing any negative consequences that may arise.
Know your customer requirements	Payment aggregators require to adhere to the guidelines on know your customer / anti-money laundering / combating financing of terrorism as required under the Master Direction - Know Your Customer (KYC) Direction, 2016, dated February 25, 2016 ("KYC Directions").	With the sensitive nature of the payment aggregation business, and several / potential incidents of money laundering and terrorism-financing, the RBI realised the need to prevent such incidents. While certainly a positive step towards reducing money laundering and terrorism- financing incidents, the process of on- boarding has become more cumbersome and less swift. Further, payment aggregators require to ensure that they have the requisite infrastructure for undertaking the obligations under the KYC Directions.
Merchant on-boarding	Along with maintaining a merchant on- boarding policy, payment aggregators must undertake checks to ensure that (i) the merchants do not sell fake / counterfeit / prohibited products, etc.; and (ii) the infrastructure of the merchants are complying with the Payment Card Industry-Data Security Standard ("PCI-DSS") and Payment Application-Data Security Standard ("PA- DSS").	To protect the interests of customers, the RBI has assigned the payment aggregators with the responsibility of conducting certain checks. Such an additional layer of checks has the direct effect of ensuring that the merchants onboarded by the payment aggregators are genuine, and further that they have in place appropriate technological infrastructures as required under PCI-DSS and PA-DSS. Payment aggregators require to undertake the relevant activities and pool in the appropriate resources for conducting such checks on the merchants.
Timelines for Settlement / Refund of Funds	Payment aggregators are required to settle / refund funds per the time frames provided under the PAPG Guidelines, the non-adherence of which may lead to scrutiny from the RBI.	The applicable time frame for settlement / refund of funds varies based on (i) contract between the payment aggregator and the merchant vis-à-vis the refund period; and (ii) the entity (payment aggregator or the merchant) responsible for the delivery of the goods. To ensure uniformity and the smooth settlement of funds, the RBI has put in place timelines for settling and refunding of funds. Any violation of the timelines will attract the scrutiny of the RBI, irrespective of whether such violation is caused by technological failures.

Key Considerations	Guidelines	Intent and Impact
Customer grievance	Payment aggregators must designate a nodal officer for handling customer complaints / grievances and escalation.	With the intention of enabling customers to have their grievances redressed, the RBI has mandated the establishment of nodal officers. Payment aggregators, thus, require utilising resources to ensure that the process of grievance redressal is smooth and enable appropriate training of the staff, as required.
Reporting requirements	Various reports are required to be submitted by the payment aggregator to the RBI on a periodic basis. These include: Reports to be submitted on an annual basis: • Net-worth certificate - audited annual report with ca certificate on net-worth – by September 30th. • IS audit report and cyber security audit report with observations noted, if any, including corrective / preventive action planned with closure date – externally audited – by may 31. the scope of audit shall encompass all relevant areas of information system processes and applications. Reports to be submitted on a quarterly basis: • Auditors' certificate on maintenance of balance in escrow account – by 15th of the month following the quarter end. • Bankers' certificate on escrow account debits and credits – internally audited – by 15th of the month following the quarter end. Reports to be submitted on a monthly basis: Statistics of transactions handled – by 7th of next month. Reports to be submitted on a non-periodic basis: • Declaration and undertaking by the director - changes in board of directors – as and when happens. • Report from Banks in compliance with paragraph 3.6 of the PAPG guidelines – one time report to be sent by April 15, 2021. • Cyber security incident reports – with root cause analysis and preventive action undertaken – by 7th of next month of incidence month.	Such disclosures by payment aggregators ensure that the RBI remains updated of any red-flags / potential red-flags that may be raised / have been raised. Payment aggregators must pool in appropriate resources for preparing such reports, and may be answerable to the questions RBI may pose to them basis these reports.

B Payment Gateways

Payment Gateways ("PG") are entities that provide technology infrastructure to route and facilitate processing of an online payment transaction. They do not handle the flow of funds.

Guidelines

Payment Gateways ("PG") do not require a license to offer payment gateway services. However, they are required to adhere to baseline technological recommendations to provide such services.

They are essentially "technology providers" and "outsourcing service providers," and are required to adhere to the guidelines on outsourcing of financial services.

Intent

While payment gateways are not regulated by the RBI, the RBI realized the need to ensure that the interests of the customers are protected.

Regulated entities such as NBFCs and banks are responsible for ensuring that payment gateways do not compromise the interests of customers, and adhere with the outsourcing guidelines as provided by the RBI.

Impact

Regulated entities are responsible for ensuring that payment gateways operate under the RBI's baseline technological recommendations and abide by the outsourcing guidelines.

❸ Payment Regulations on Cross Border Remittance in India

Cross-border remittances have grown to be one of the largest sources of external financing in India. RBI regulates and issues guidelines for cross-border payments through various channels.
Cross border transactions in India are regulated by the Foreign Exchange Management Act, 1999 ("FEMA"), which is the applicable legal regime for exchange control. FEMA empowers RBI to regulate transactions coming to and going from India in which either one of the parties is located in India.

All transactions which involve remitting/ receiving money from abroad can only be done through RBI- authorized categories of Authorized Persons ("APs") as stipulated under FEMA. APs include an authorized dealer, money changer, offshore banking unit or any other person authorized by RBI to deal in foreign exchange or foreign securities.

These permitted entities can only then facilitate transactions in foreign exchange as instructed by the sender or the receiver under the permissible route for remittances as set out by RBI. The approval of the license depends on various factors such as the net worth requirement, the type of company established in India, prudential requirements etc.

Ⓐ Licensing Requirements:

The Licenses Available To Aps To Offer Cross – Border Services

1. **Authorized Dealer – I:** These are Commercial Banks, State Co – operative Banks, Urban Co – operative Banks and Small Finance Banks which are authorized by the RBI to undertake both current and capital account transactions.
2. **Authorized Dealer – II:** This license is available to Regional Rural Co – operative Banks, Co – operative Banks, upgraded full – fledged money changers ("FFMCs") and other entities. They are permitted to undertake certain non – trade related current account transactions.
3. **Authorized Dealer – III:** This license is only available to select financial institutions for transactions which are incidental to foreign exchange.
4. **Full Fledged Money Changers:** These entities are authorized to purchase and sell foreign exchange from residents/ non – residents visiting India for private and business travel purposes only. The entity applying for this license should be a registered company under the Companies Act, 2013 having a minimum net fund of (i) INR 25 lakhs for a single branch FFMC; and (ii) INR 50 lakhs for a multiple branch FFMC.
   -Authorised Dealers ("AD Banks") are subjected to a higher degree of regulatory oversight and supervision by the RBI since in practice most cross – border remittances are done through these AD Banks.
   -The Authorised Dealer – I Banks are permitted to undertake the broadest nature of transactions amongst all four available licenses. Other entities apart from banks, mainly only Authorised Dealer – II and FFMC are permitted to offer remittance services directly, basis authorization by RBI.

B Introduction of Forex Correspondents under the Draft Licensing Framework for Authorised Persons

In line with ongoing liberalization under FEMA, citing increasing integration of the Indian economy with the global economy, digitisation of payment systems, evolving institutional structure, etc., RBI has published the Draft Licensing Framework for Authorised Persons (APs) under FEMA, on December 26, 2023 ("Draft AP Framework"), for public comments and feedback.

Intent

In order to promote ease of doing business, the RBI under this framework has proposed to introduce a new category of money changers called "Forex Correspondents" ("FxCs"). Such FxCs would operate in the form of an agency and would conduct money-changing business on behalf of Category-I and Category-II Authorised Dealers. The following are the features of such proposed FxCs –

- FxCs will be allowed to conduct foreign exchange business as an agent of AD Cat I Bank/ AD Cat II. FxCs can have only one such arrangement at a time with principal AD. FxCs do not require authorization of RBI.
- Permissible Activities: distribution of forex cards, purchase/ sale of foreign currency notes/ travellers cheques for foreign private and business travel. May also be appointed as Sub-Agent of principal AD Cat I/ AD Cat II under MTSS.
- Eligibility: (i) existing FFMC; (ii) AD Cat II (after surrender/ lapse of license); (iii) NBFC; (iv) Bank; and (v) a company, as defined in Companies Act, 2013.
- Transactions facilitated by FxCs are proposed to be on the books of the principal AD.
- Principal Authorised Dealers Category I Bank/ Category II Banks required to have Board approved policy for engaging with FxCs. An alternative for Foreign Exchange Dealers Association of India to provide a standard eligibility criteria for engaging FxCs.

Impact

The proposed Draft AP framework also seeks changes in the eligibility criteria and authorization process for Category I & II Authorised Dealers. Such a framework would align the foreign exchange management framework in the country, which was long due updation, with the increasing globalization of Indian payment systems.

C Permissible Routes for Remittances

The green channel through which the transmission of funds will take place

Outward Remittance

Under the Liberalized Remittance Scheme ("LRS"), resident individuals, barring corporates, partnership firms, Hindu Undivided Families, Trusts, are allowed to freely remit up to USD 2,50,000 per financial year for permissible current or capital account transaction or a combination of both through their AD Bank.

Inward Remittance

Money Transfer Service Scheme ("MTSS"): MTSS facilitates receiving of personal remittances from abroad to beneficiaries in India. Personal remittances primarily include maintenance for families and remittances for foreign tourists visiting India. Under this system, an arrangement is entered into between reputed money transfer companies abroad and an Indian Agent to transmit and disburse funds to the beneficiaries in India. The entities having a minimum net owned fund of INR 50 lakhs eligible to become an IA are (i) Authorised Dealer Category-I bank; (ii) Authorised Dealer Category-II; (iii) FFMCs; and (iv) Scheduled Commercial Banks.

Rupee Drawing Arrangement ("RDA"): RDA is a channel to receive cross – border remittances from overseas jurisdictions. Under this system, an arrangement is envisaged between the Authorized Dealer Category – I Banks and non – resident Exchange Houses which are licensed companies and financial institutions regulated by a competent authority from the sender's jurisdiction. The beneficiary is remitted funds through a Rupee denominated Vostro Account of the non – resident Exchange House held with the Authorised Dealer Category – I Bank.

Inward and outward remittance

Wire Transfers: In India, banks use wire transfers for transferring funds between banks accounts, domestically and internationally Further, there is no actual movement of currency between the accounts resulting in an expeditious transfer of value. There are essentially three players involved in a wire transfer between banks (i) Originating Bank the bank which places the order based on the instructions received by its customer; (ii) Intermediary Bank the bank which receives the information and further transmits it and (iii) Beneficiary Bank the bank which remits the funds to the receiver basis the information received.

Correspondent Banking Network:

To facilitate faster remittance services for their customers, banks enter into a correspondent banking arrangement with other banks i.e., Respondent Bank. Under this network, various banking services are exchanged inter alia between the banks such as cash/funds management, international wire transfers, drawing arrangements for demand drafts and mail transfers, payable-through-accounts, cheque clearing, etc. The globally operated Society for Worldwide Interbank Financial Telecommunication ("SWIFT") Mechanism is used by the Indian Banks for their correspondent banking relationships.

- Per Section 3 of FEMA, unless specifically permitted, all cross-border remittances (both inward/ outward), are prohibited.
- Per Section 3(d) of FEMA, receipt of payment by order or on behalf of any person resident outside India is restricted, including by an authorized person unless a corresponding inward remittance from the place outside India is received.

❹ Payments – Other Key Updates

Key Considerations	Guidelines	Impact
Tax Collected at Source ("TCS") on Remittances	The Union Budget (February 2023) involves a significant development on TCS for foreign transactions. The rate of TCS has now increased from 5% to 20% for all remittances under LRS except those related to medical treatment or education. The new TCS will come into effect from October 1, 2023.	This will help in ensuring that those spending money abroad file returns in their own country. It will lead to increase in tax revenue.
Unified Payment Interface ("UPI") payment facility for foreign travellers	It has now been proposed to permit all inbound travellers to India also to access UPI for their merchant payments ("P2M") while they are in India. To start with, this facility will be extended to travellers from the G-20 countries, arriving at select international airports. Going forward, this facility will be enabled across all other entry points in the country.	This proposal seeks to promote usage of digital payments in India and offer a more seamless payment experience for tourists travelling to India. It is a significant step that is expected to benefit both merchants as well as the travellers.
Bharat Bill Payment System ("BBPS")	The BBPS is an interoperable platform for standardised bill payments. NRIs can now use BBPS to pay utility bills and education fees on behalf of their family members in India.	This will boost digital payments in India enabling digital collections in both domestic and international markets. It will also streamline the overall system and encourage consumers to make payments via digital channels rather than by visiting branches.
Wire Transfers	According to the updated guidelines by the RBI, all cross-border wire transfers from India must include accurate, complete, and relevant details of the remittance along with the relevant laws.	The RBI's move is anticipated to bolster India's endeavours to combat money laundering and align the country with internationally recognized standards in this domain
Central Bank Digital Currencies ("CBDCs")	The addition of Section 22A to the Finance Bill, 2022, has outlined India's plans to launch a CBDC, signalling a significant shift in the country's stance on centralised fiat payment regimes. As per the Reserve Bank of India ("RBI"), the Digital Rupee, 'e₹' is interchangeable with the current currency and will be accepted as a medium of exchange, legal tender, and a secure store of value.	CBDC is a central bank-issued digital equivalent of currency notes. It will be simpler, faster, and less expensive, and will have all the transactional advantages of other digital currencies even across cross border transactions.

5 Payment Aggregator - Cross Border Guidelines

Regulation of PA-CB (PA-CB Circular)

The Department of Payment and Settlement Systems of the Reserve Bank of India ("RBI") issued the Circular on Regulation of Payment Aggregator – Cross Border, on October 31, 2023 ("PA-CB Guidelines"), bringing all entities facilitating online cross-border payments for import and export of permissible goods/ services, under RBI's direct regulation, with such entities being termed as payment aggregators - cross-border. The guideline doesn't apply to remittances and non-trade related transactions.

Through these directions, the RBI primarily aims to create a uniform framework for governing all entities that facilitate cross-border online payments for trade transactions. This is primarily a step towards consolidation of regulatory landscape for domestic and cross border payment aggregation. Further, this may also provide an opportunity for collaboration between domestic and cross border players in merchant acquisition and collections space.

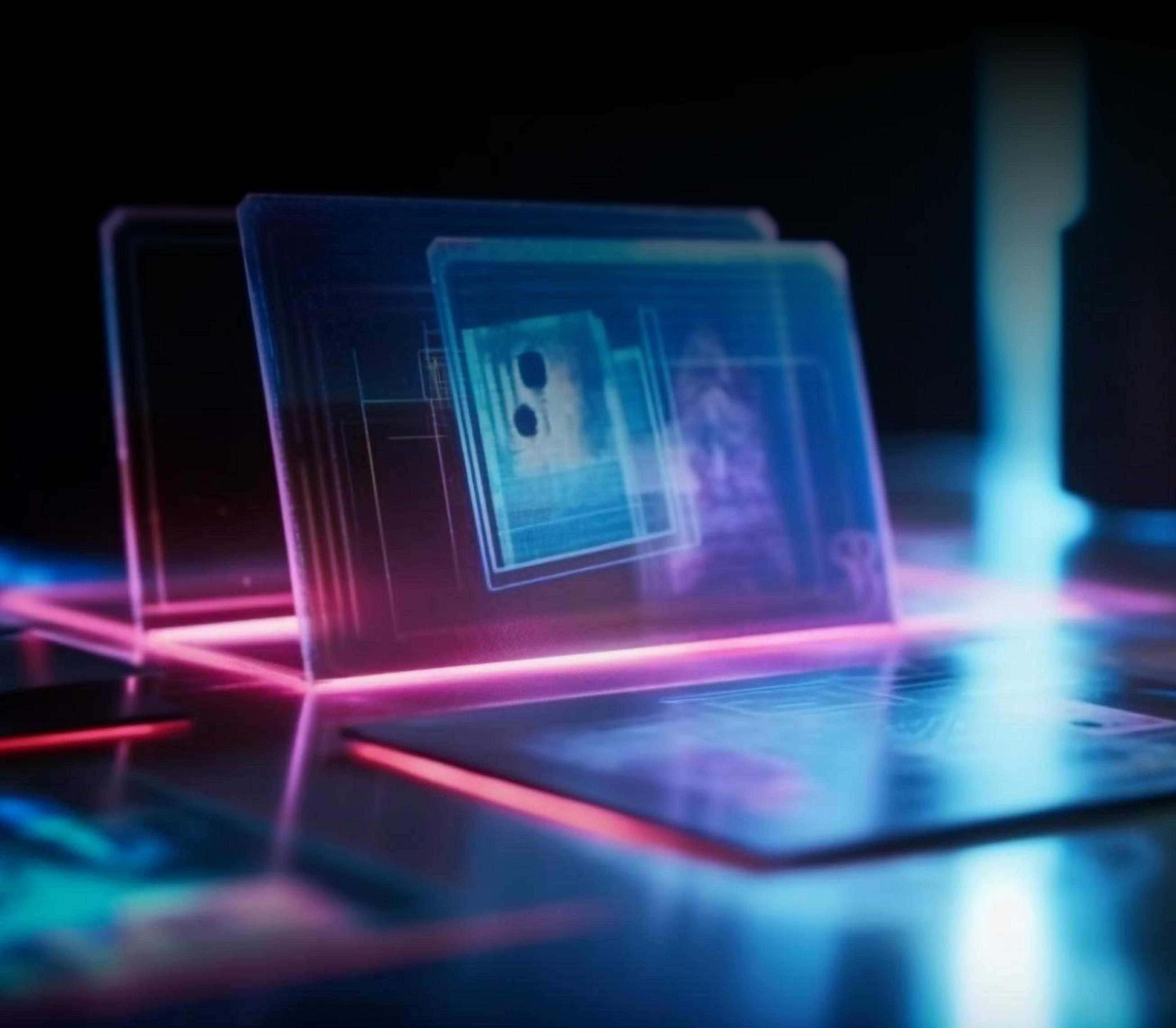
Key Considerations	Guidelines	Intent and Impact
Authorisation	All existing PA providers engaged/ intending to engage in cross border transactions ("PA-CB") require applying to the RBI for undertaking cross-border transactions. Further, a single authorisation will be required by a non-bank to undertake PA and PA cross-border (PA-CB) activity. Domestic PAs, awaiting final approval and presently not undertaking Cross-Border PA activity, can apply for Cross-Border PA only after final PA authorization AD-I Banks do not require a separate approval from the RBI for undertaking PA-CB activities.	The RBI, by way of PA-CB Guidelines has now opened up cross-border payment aggregation business for nonbank entities, which was earlier the exclusive domain of AD Banks. Earlier, such entities involved in cross-border payments for import and export of goods and services tied up with Authorised Dealer Category I Banks ("AD Banks") to operate as online payment gateway service providers ("OPGSPs") and collection agents, and were supervised through such AD Banks.
Net worth	Existing non-bank PA-CBs require to have a minimum net worth of INR 15 crores at the time of submission of application. They must achieve a net worth of INR 25 crores by March 31, 2026. New PA-CBs must, on the date of the application, achieve a minimum net worth of INR 15 crores. and attain a minimum net-worth of INR 25 crores by the end of the 3rd financial year of grant of authorisation.	To ensure security that PA-CBs have enough capital to continue their activities and mitigate risks. This will act as a potential entry barrier for one to enter the space and we might witness consolidation.

Key Considerations	Guidelines	Intent and Impact
Categories	All PA-CBs have been categorised into 3 (three) categories: • PA-CBs facilitating cross border transactions for export of goods and services ("PA-CB-E"). • PA-CBs facilitating cross border transactions for import of goods and service ("PA-CB-I"). • PA-CBs facilitating cross border transactions for both import and export of goods and services ("PA-CB-E&I").	To clearly demarcate the different PA-CBs in the payment space and providing different obligations for each.
Accounts	• A-CB-E: PA-CB-Es require to maintain separate export collection accounts ("ECA") for each non-INR currency with an AD-I Bank. • PA-CB-I: PA-CB-Is must maintain an import collection account ("ICA") with AD-I Banks. • Separate ICA and ECA collection accounts require to be maintained for facilitating import and export transactions.	Prevent co-mingling of funds.
Value of goods and services	In respect of import and export transactions processed by PA-CBs, the maximum value per unit of goods / services sold / purchased must not exceed be INR 25,00,000. PA-CBs must undertake due diligence of the buyer if per unit goods / services imported is more than INR 2,50,000.	This is a significant increase from the earlier transaction limit, being ~INR 1,60,000 (USD 2,000) for import and ~INR 8,30,000 (USD 10,000) for export transactions. This will boost total number of cross-border e-commerce transaction.
Adherence to guidelines	The entities carrying out this activity should ensure adherence to the guidelines on governance, merchant on-boarding, customer grievance redressal and dispute management framework, baseline technology recommendations, security, fraud prevention and risk management framework (provided in the March 17, 2020 circular – PA Guidelines) within a period of three months from the date of this circular and should be complied with on an ongoing basis thereafter. Further, this also shifts certain compliance responsibilities from AD Banks to Cross Border PAs, such as reporting of suspicious transactions to the Financial Intelligence Unit – India ("FIU-Ind"), etc.	PAs are poised for a major transformation, both in terms of organisation and technology, to align with the stringent requirements of the PA-CB Circular. This will necessitate a substantial financial outlay to implement robust safeguards, establish safe and secure technological infrastructure and adhere to the comprehensive compliance and reporting requirements outlined in the PA Guidelines.

6 Payments – Global Regulatory Benchmarking

	India	Singapore	European Union	United Arab Emirates
Licensing Requirement	Authorisation for any payment system needs to be received under the Payment and Settlement Systems Act, 2007.	Three type of licenses: 1. Standard Payment Institution Licence. 2. Major Payment Institution License. 3. Money Changing License.	Players have to obtain an e-money license from any EU country, whose passporting feature allows such a player to provide its services to other EU and EEA countries.	Recognises nine categories of digital payment services, including payment aggregation. License required for any such Payment services.
Initial Capital Requirement	The initial capital requirement would depend on the type of payment system. For instance, in case of PAs, the initial capital requirement is INR 15 crores at the time of application, required to grow to INR 25 crore from three years from date of authorisation	For Standard Payment Institution License: If Payment service provider is incorporated in Singapore - minimum $100,000. If incorporated outside Singapore, head office funds of minimum - $100,000. For Major Payment Institution License: If incorporated in Singapore - minimum $250,000. If incorporated outside Singapore, head office funds of minimum - $250,000.	E-money license-holders are required to have an initial capital of not less than EUR 350,000	Range from AED 100,000 to AED 3 million.
Storage of Information	Merchants are not allowed to store payment data or customer card credentials within its database or server, except for the limited purpose of transaction tracking.	Any sensitive or confidential data that is stored needs to be encrypted and protected by strong access controls.	E-money license-holders must adhere to the fundamental data protection principles outlined in GDPR	Guidelines on storage of information are not mentioned.

Data Protection



Data Protection – Global Legislation Benchmarking

India being one of the world's largest data markets after China, introduced its data privacy law and ushered in a new era of its data privacy regime. The Digital Personal Data Protection Act, 2023 ("DPDPA") provides tighter and better control over the use of customer information by companies and businesses. Some of the key departures between the European Union's GDPR and India's DPDPA and Singapore's PDPA are as follows:

	Digital Personal Data Protection Act, 2023 ("DPDPA")	General Data Protection Regulation, 2016 ("GDPR")	Personal Data Protection Act, 2012 ("PDPA")
Applicability and Scope	Applies to the processing of digital personal data (online or digitised) within India. Applies to the processing of personal data outside India, if it is for offering goods or services in India. Does not apply to publicly available data.	The GDPR applies to organisations that have presence in the EU. GDPR applies to the processing activities of data controllers (akin to data fiduciaries under DPDPA) and data processors that do not have any presence in the EU, where processing activities are related to the offering of goods, or services to individuals in the EU, or to the monitoring of the behaviour of individuals in the EU. The GDPR excludes data processing for purely personal or household purposes and in context of national security.	Applies to the processing of digital personal data (online and digitised) within Singapore, and to all organisations that collect, use, or disclose data within Singapore. Such organisations may not have a physical presence. Does not apply to 'business contact information', personal data contained in a record in existence for at least 100 years and personal data on persons who have ceased to exist for over 10 years.
Personal Data	The DPDPA defines "personal data" as any data about an individual who is identifiable by or in relation to such data. No differentiation has been made of several classes of data. Further, the act only covers processing of personal data by partly or wholly automated means.	GDPR defines personal data as data by which a natural person can, directly or indirectly, be identified. In addition to that, a distinction is made between 'regular' personal data and 'special" categories of personal data.	There is no special category for sensitive personal data in the PDPA, However, in Breach Notification Regulations, the Personal Data Protection Commission of Singapore prescribes a list of data that, if subject to a data breach, would be deemed to result in significant harm to individuals including medical, financial, child information etc. "Processing" personal data means carrying out operations such as recording, holding, organising, adapting, altering, retrieving, combining, transmitting and destroying such personal data.

Consent	Personal data may be processed only for a lawful purpose after obtaining the consent of the individual. The consent should be freely given, specific, informed and unambiguous, with clear affirmative action. The consent should be limited to such personal data as is necessary for the specified purpose in the request for consent. The data principal has the right to withdraw their consent where consent is the basis of processing of their data.	Consent is only one of six bases mentioned in the General Data Protection Regulation (GDPR). The others are: contract, legal obligations, vital interests of the data subject, public interest and legitimate interest. Consent must be freely given, specific, informed and unambiguous. In order to obtain freely given consent, it must be given on a voluntary basis. The data subject must also be informed about his or her right to withdraw consent anytime. The withdrawal must be as easy as giving consent.	Organisations are required to obtain individuals' consent to collect, use, or disclose their personal data unless otherwise authorised under law. An organisation must notify the individual of the purpose and may only collect, use, and disclose personal data for such purposes. Individuals can withdraw any consent given or deemed to have been given at any time by giving reasonable notice. The withdrawal will apply prospectively.
Deemed Consent	"Certain legitimate uses" clause replaces the "deemed consent" clause of DPDPB, 2022. The clause states that processing of personal data may be done without obtaining the informed consent of the data principal in certain situations.	The GDPR provides for a basis for processing data termed as "necessary for purposes of legitimate interests".	The PDPA provides for three different forms of deemed consent: (i) deemed consent by conduct; (ii) deemed consent by contractual necessity; and (iii) deemed consent by notification
Cookie Law	DPDPA is silent on cookie law, but requires consent for taking any personal information from the data principal.	EU cookie law, also known as the ePrivacy Directive, is a privacy legislation that requires sites to get consent from visitors before placing cookies on their devices. Accurate and specific information about the data each cookie tracks, along with its purpose must be provided in plain language.	PDPA is silent on cookie law, but requires consent for taking any personal information from the data principal.
Significant Data Fiduciary	Significant data fiduciaries are certain classes of data fiduciaries as notified by the Indian Government, basis the volume and sensitivity of personal data processed, risk it poses to the rights of the data principal, security of the country, public order etc. Significant data fiduciaries have the duty to appoint data protection officers, appoint independent data auditors, undertake data protection impact assessment etc	There is no equivalent of a significant data fiduciary.	There is no equivalent of a significant data fiduciary.

Data Processors & Consent Managers	Data fiduciaries may appoint a data processor to process personal data on its behalf. DPDPA primarily obligates the data fiduciary for compliances and data processors do not have specific obligations as such. A data principal may give, manage, review or withdraw their consent to the data fiduciary through a Consent manager.	GDPR also recognises data processors and their obligations are identical to data controllers. However, the processor's liability is limited as per paragraph 2 to violations of obligations which are specific to him. Consent Manager is not provided for.	An organisation can engage a data intermediary to process personal data on its behalf. Data intermediaries do not have any obligations under the PDPA; any obligations on the data intermediary shall be basis the contractual terms between the data intermediary and the organisation. Consent manager is not provided for.
Data Principals	Data Principal will have the right to (i) obtain information about processing; (ii) seek correction and erasure of personal data; and (iii) nominate another individual for carrying out activities of a data principal.	Data Principal will have the right to (i) obtain information about processing; (ii) seek correction and erasure of personal data; and (iii) nominate another individual for carrying out activities of a data principal.	The individual has the right to request information about processing and the right to correct and access their personal data. The PDPA does not provide data subjects with the right to erasure of data.
Obligations & Data Fiduciaries	Data Fiduciary, must: (i) Make reasonable efforts to ensure the accuracy of the data; (ii) Erase personal data as soon as the purpose has been met and in the event that the principal withdraws their consent for sharing such data;	'Privacy by Design' and 'Privacy by Default' are required. Each controller and processor will have the responsibility to maintain records of all the processing activities. The GDPR obligates data controller to rectify and erase data on data subject's request.	An organisation must, upon request, allow an individual to access and/or correct their personal data in its possession or under its control. In addition, the organisation is obliged to provide the individual with information about the ways in which personal data may have been used during the past year. Upon withdrawal of consent, the organisation is required to cease and cause its data processors to cease processing of such data.
Cross-Border Data Transfer	The Act allows transfer of personal data outside India, except to countries restricted by the central government through notification. The Act follows a "blacklisting" approach for cross-border transfer and processing of personal data, meaning that the government would specify certain geographies where data cannot be processed.	The GDPR essentially distinguishes between countries outside the European Economic Area (EEA) that are considered to ensure an adequate level of protection for personal data and "non-adequate" countries. Further, the provision is to identify and whitelist jurisdictions that follow and implement adequate legal standards for processing of data within their geographies. Under the GDPR, Article 49 sets out a limited number of derogations which can be used for specific situations involving data transfers to jurisdictions that lack an adequacy finding by the E.U. regulators.	Transfer Limitation Obligation: An organisation must not transfer personal data to a country or territory outside Singapore except in accordance with requirements prescribed under the PDPA.

	India	EU	Singapore
Right to Retain Data & Purging Rights	The data fiduciary must erase and cause its data processor to erase the personal data, (i) upon receipt of a consent withdrawal request; or (ii) as soon as it is reasonable to assume that the specified purpose is no longer being served, whichever is earlier, unless retention is necessary for compliance of any law in force.	If a person objects to data processing activities or withdraws consent, the organization has to end such activities unless compelling legitimate grounds exist.	An organisation must cease to retain documents containing personal data or remove the means by which the personal data can be associated with particular individuals, as soon as it is reasonable to assume that the retention of such personal data no longer serves the purpose for which it was collected and is no longer necessary for legal or business purposes. Further, upon withdrawal of consent, the organisation is required to cease and cause its data processors to cease processing of such data.
Exemptions	Rights of the data principal and obligations of data fiduciaries (except data security) will not apply in specified cases, such as (i) prevention and investigation of offences; and (ii) enforcement of legal rights or claims. The central government may, by notification, exempt certain activities from the application of the DPDPA. These include: (i) processing by government entities in the interest of the security of the state and public order, and (ii) research, archiving, or statistical purposes. The DPDPA empowers the central government to notify certain data fiduciaries or classes of data fiduciaries, including startups, regarding certain obligations. The requirement to seek free and informed consent will continue to apply in case of these entities	The GDPR contains broad derogations and exemptions in two main areas: (1) in Chapter III Section 5, regarding "restrictions" to obligations and data protection rights; and (2) in Chapter IX, regarding "specific processing situations". Specific (Art. 85-91)- freedom of expression and information, public access to official documents, national identification numbers, employee data, scientific and historical research purposes or statistical purposes, archiving in the public interest, obligations of secrecy, churches and religious associations.	Categories of entities excluded from the application of the PDPA include (i) individuals acting in a personal or domestic capacity; (ii) employees acting in the course of their employment with an organisation; (iii) public agencies; or (iv) any other organisation as may be prescribed. Consent is not required for specific exceptions in the First Schedule and the Second Schedule to the PDPA apply to legitimate interest, publicly available data, individual's interest and national interest.
Data Portability & Right to be Forgotten	The DPDPA does not provide for either.	GDPR recognizes both these rights.	The PDPA only recognizes data portability obligation.
Consent of Child	Child is below 18 years of age. The Act requires all data fiduciaries to obtain verifiable consent from the legal guardian before processing the personal data of a child and prohibits such processing of such data for tracking and monitoring children or for any activity which may have a detrimental effect.	GDPR sets it at 16, reducible to 13 by member countries.	PDPA does not define an age but guidelines follow the thumb rule of 13.

Penalties	The Act lays down a schedule, laying down the range of penalties for specific contraventions, with the highest such amount being INR 250 crore for a breach in observing the obligation of Data Fiduciary to take reasonable security safeguards to prevent personal data breach under sub-section (5) of section 8.	Fine of up to €20 million, or 4% of the firm's worldwide annual revenue from the preceding financial year, whichever amount is higher.	Financial penalty of (approx. up to a maximum of 10% of the organisation's annual turnover in Singapore or up to SGD 1 million based on annual turnover.

Miscellaneous Developments

❶ Recent Developments

Ⓐ Regulating "Dark Patterns"

In order to address and regulate deceptive design practices in digital interfaces the Department of Consumer Affairs ("DoCA") has introduced the Guidelines for Prevention and Regulation of Dark Patterns as of December 2023.

Guidelines

The guidelines focus on identifying, preventing, and regulating "dark patterns" in digital interfaces. Dark Patterns are any practices or deceptive design patterns using UI/UX (user interface/user experience) interactions on any platform; designed to mislead or trick users to do something they originally did not intend or want to do; by subverting or impairing the consumer autonomy, decision making or choice; amounting to misleading advertisement or unfair trade practice or violation of consumer rights.

We have enlisted some type of specified dark patterns below:

- **False Urgency:** Creating a misleading sense of urgency, e.g., using countdown timers for offers that aren't time-limited.
- **Basket Sneaking:** Adding additional items or services to a user's shopping cart without explicit consent, often during checkout.
- **Confirm Shaming:** Using negative language to shame users who opt out of certain options, like newsletter subscriptions.
- **Forced Action:** Requiring users to perform a specific action, such as sharing personal data, to access basic functionalities.
- **Subscription Traps:** Hiding terms of subscription services, making it hard to understand or cancel recurring charges.
- **Interface Interference:** Designing interfaces to mislead or confuse users, such as disguising ads as content or making the 'decline' button hard to find.
- **Bait and Switch:** Advertising a product or service at a certain quality or price and then substituting it with a lower quality or higher priced option.
- **Drip Pricing:** Initially showing a lower price and then adding additional costs (like taxes, service fees) at the end of the purchase process.
- **Disguised Advertisements:** Making ads look like regular content or navigation elements, misleading the user about their nature.
- **Nagging:** Repeatedly prompting or nudging the user to perform an action, creating an annoyance or distraction.
- **Trick Questions:** Framing questions or choices in a way that tricks users into selecting options against their interests.

Intent

The introduction of these guidelines is a response to growing concerns over consumer rights and protection in the digital sphere. They aim to enhance transparency, fairness, and accountability in digital interactions, particularly in e-commerce and digital advertising.

Key points to note

- Applicability to all platforms, advertisers, and sellers systematically offering good and services in India.
- Prohibitions against engaging in dark patterns and conditions that characterize such engagement.
- Integration with other existing laws and the authority of the Central Consumer Protection Authority (CCPA) in interpretation and enforcement.

Impact

- These guidelines could lead to significant changes in how fintech and startups design their digital interfaces, requiring more transparent and user-friendly practices.
- They might increase operational and compliance costs for these companies, as they will need to audit and possibly redesign their UI/UX to avoid prohibited practices.
- The guidelines could also improve consumer trust and confidence in digital platforms, potentially benefiting ethical and transparent businesses.
- Startups and fintech companies might need to invest in legal and compliance expertise to navigate these new regulations effectively.

B Green Credit Rules, 2023 and Carbon Credit Trading Scheme, 2023

Intent & Impact

With an aim to promote sustainability and reduce carbon emissions, the Carbon Credit Trading Scheme and Green Credit Rules were launched under the Lifestyle of Environment (LiFE) initiative in 2023. The Carbon Credit Trading Scheme has been enacted under the Energy Conservation Act, 2001, whereas the Green Credit Rules fall under the Environment (Protection) Act, 1986.

To achieve a net zero emission by 2070, a market-based incentive mechanism for different kinds of environment-positive actions has been created. In short, there will be a market-based system which will allow companies and individuals to trade in carbon credits. Companies or nations can claim carbon credits if they take action to reduce their carbon footprint. These credits can then be traded for money. Companies unable to achieve their emission standards pay to buy these credits and improve their performance.

The rules envision a scenario where an environment-positive activity generating green credits may also be eligible for carbon credits under the Carbon Credit Trading Scheme ("CCTS"). However, there is a need to elaborate upon identifying activities for issuance of carbon credits under the CCTS, fixation of tenure of green credits and carbon credits to ensure participation under both credit systems and calculation of benefits available to stakeholders earning green credits as well as carbon credits. For example, an activity that earns both green and carbon credits may be traded independently by participants or may be traded subject to thresholds fixed for availing benefits arising out of such trades. Therefore, a clarification on the inter-relationship between both is awaited.

Key Considerations	Green Credit Rules, 2023	Carbon Credit Trading Scheme, 2023	Remarks
Regulator	Regulated by Ministry of Environment, Forest and Climate Change ("MoEFCC"). Further, IFCRE will be administrator i.e. responsible for the effective implementation of the Green Credit programme, including its management and operation under these rules.	Regulated by Ministry of Power. Under the CCTS, the Bureau would be the administrator and Central Electricity Regulatory Commission has the authority to settle disputes arising out of trading of carbon credits.	The presence of two different authorities in adjudicating issues arising out of trading of green and carbon credits may lead to differences in development of two similar markets.
Activities Covered	Covers more environment-positive actions and currently have 8 activities which are notified. These include activities to increase forest cover, manage water resources, promote sustainable agriculture practices, manage waste, reduce air pollution, conserve and restore mangroves, foster ecomark labelling of eligible products,and promote sustainable buildings and infrastructure.	Covers reduction of greenhouse gases emission.	The GCPR is meant to complement the CCTS and looks beyond carbon.
Participants	Entails voluntary participation of individuals, industries, corporations, etc.	Focused on industry and corporations. May include high energy-intensive industries such as cement, fertilisers, iron and steel, etc. These obligated entities emitting carbon within the limits set out, are entitled to receive carbon credits, which can then be sold to entities exceeding their quotas.	

C National Deeptech Startup Policy

A deep tech startup is characterized by its involvement in early-stage technologies that are rooted in scientific or engineering advancements. These technologies are typically in their nascent stages and have not yet found commercial applications. What sets deep tech startups apart is their focus on developing solutions through unexplored pathways, either by advancing new knowledge in a specific scientific or engineering discipline or by amalgamating insights from multiple disciplines. The capacity of these startups to generate and own Intellectual Property (IP) is a key distinguishing factor from non-deep tech startups. Moreover, deep tech startups often operate in areas marked by considerable opportunities or risks, owing to the significant technical or scientific uncertainties they navigate. These ventures are also characterized by extended development timelines and a high need for capital investment.

Policy Overview

The National Deeptech Policy is a pivotal initiative aimed at transforming India into a hub for deep tech startups. This policy primarily focuses on empowering these startups by enhancing high-tech exports and boosting the nation's economic competitiveness. A key objective is to foster a self-reliant ecosystem, one that is conducive to innovation, collaboration, and sustainable growth. To achieve this, the policy lays out a framework to nurture startups right from their foundational stage. This includes providing comprehensive support in areas such as research, funding, and navigating regulatory landscapes. The overarching goal is to create an environment where deep tech startups can thrive and contribute significantly to the country's technological prowess.

Key Policy Elements

- **R&D Support:** Significant increase in government and private sector investment in research; promoting participation of private capital investment for longer terms to enable growth of high risk ventures.
- **IP Strengthening:** Building a robust IP framework to protect innovations and encourage global competitiveness;
- Potentially establishing a unified IP framework customized to deep tech startups;
- Streamlining patent application process for efficient protection of deep tech startups;
- **Funding:** Establishing specialized funds for deep tech startups, offering both equity and non-equity financial support. Potentially designing specialized financial products for deep-tech startups due to the longer duration of financial commitment required.
- **Shared Resources:** Developing incubators, accelerators, and shared facilities to lower operational costs for startups.
- **Regulatory Environment:** Simplifying regulations, ensuring faster clearances and support for international expansions.
- **Diversity and Capacity Building:** Initiatives to promote diversity in the tech sector and upskill the workforce.

Intent

The introduction of the National Deeptech Policy is underpinned by the recognition of the transformative potential of deep tech in driving both economic and societal progress. This policy is a strategic step towards positioning India as a global leader in deep tech innovations. It acknowledges the existing challenges faced by deep tech ventures, including gaps in funding, infrastructure, and policy support. By addressing these critical areas, the policy aims to unlock the full potential of deep tech startups, enabling them to contribute significantly to the nation's technological advancement and economic growth. This initiative represents a commitment to not only support the current generation of deep tech entrepreneurs but also to lay a robust foundation for future innovators in this dynamic and evolving sector.

Impact

- **Innovation Growth:** Promotes cutting-edge technological advancements, positioning startups at the forefront of global innovation.
- **Market Competitiveness:** Supports the creation of unique, market-disrupting products and services.
- **IP Support:** Enhances the ability of startups to protect their intellectual property, fostering a culture of innovation.
- **Financial Support:** Greater access to funding helps startups scale and sustain their operations.
- **Global Positioning:** Elevates India's profile in the international tech landscape, attracting foreign investment and collaborations

❷ Forseeable Regulations

Ⓐ Framework for Connected Lending

Connected Lending refers to lending to persons who can control or influence the lender's decision if an arm's length relationship is not maintained. To address the paucity of regulations covering these lending arrangements where there may be issues of compromise in pricing and credit management, the RBI intends to release a draft circular for a unified regulatory framework for all regulated entities.

This decision by RBI can be seen as a mechanism to restrict conglomerate-owned banks from manipulating the lending ecosystem and its practices indirectly.

This issue was also highlighted earlier in RBI's Working Group Report on Digital Lending (Working Group Report). This step can also be seen as RBI's continued monitoring over governance, conflict of interest, misallocation of credit and concentration risks in the lending ecosystem.

Though currently, if the loan is disbursed to the related entities then the amount of loan disbursed is not included in net worth calculation and simultaneously it is included under Risk Weighted Assets which impacts Capital Adequacy Ratio (CAR) of NBFCs.

Ⓑ Framework on Web Aggregators of Loan Products

The RBI has accepted the recommendation of the Working Group Report to develop a regulatory framework for web aggregation of loan products.

Web Aggregators of Loan Products (WALP) entails aggregation of loan offers from multiple lenders on an electronic platform which enables the borrowers to compare and choose the best available option to avail loan from one of the available lenders. The proposed framework would bring WALP services offered by Lending Service Providers (LSPs) under its ambit, with a focus on enhancing transparency and regulating the operations of WALPs within its fold. This is another step towards the customer centric outlook of the regulators enabling borrowers to have access to all the relevant information and transparency while undertaking services from such platforms engaged in WALPs.

The proposed regulatory framework would impact LSPs and digital lending applications which were recognized by the RBI through the Digital Lending Guidelines issued in 2022. The lending ecosystem is anticipating a regulation similar to insurance web aggregators where IRDAI had prescribed a framework on conducting their operations.

C Regulating "Deepfakes"

Deepfakes refer to images, voice, video, actions or recordings that are been convincingly altered and manipulated to misrepresent someone As such manipulation is hyper-realistic in nature, they can be used rather effectively to fabricate evidence, defame and defraud. Deepfake advertisements and misleading promotions are threats to both the society and democracy. Previously, in India, such doctored content has been used to sabotage political campaigns – and has only been on the rise since.

As the current legal and regulatory framework proves insufficient to deal with deepfakes, the Ministry of Electronics & Information Technology ("MeitY") has announced actionable items on four pillars:
(i) detection of deepfakes;
(ii) preventing the spread of such content;
(iii) strengthening reporting mechanisms; and
(iv) spreading awareness on the issue.

There is a possibility that new regulations could impose penalties on both creator and platform hosting deepfakes,

As the government is taking a strict stance against such technology, it has also warned social media platforms that they could lose the "safe harbour" immunity provided to them under in the Information Technology Act, 2000 if they fail to take appropriate measures. Such protection states that online platforms cannot be held accountable for the content shared by users.

As an immediate measure, the MeitY has directed intermediaries to inform their respective users 'clearly and precisely' about what kind of content is prohibited, especially the ones specified under Rule 3(1)(b) of the The Information Technology (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021 ("IT Rules").. Rule 3(1)(b) of the IT Rules aims to ensure platforms identify and promptly remove misinformation, false or misleading content, and material impersonating others, including deepfakes.

D Neo Banks

Neo Banks are entities that provide banking services on a purely digital model, although they are not "banks" as they do not hold banking licenses or perform core banking activities. Besides, as they are currently unregulated by the RBI, due caution is to be exercised when partaking in transactions with such entities. Despite the caveat, there has been a surge in such structures, due to their ability to on-board and make banking accessible to a younger audience.

Intent & Impact

Such structures are also lucrative for small players in the lending space as they tend to save on capital costs such as rent and infrastructure. This allows them to offer services at prices much lower than traditional brick-and-mortar banks. For instance, some neo banks offer zero-balance accounts, while some may be offering higher interest rates.

Due to the advantages for both parties, scheduled banks have been entering into agreements with neo banks where the latter acts as a means of customer acquisition and the former provides institutional support. Currently, the compliances to be followed by neo banks are those arising from its relationship with scheduled banks. However, as the independent entities themselves are not under the RBI's purview, the stability and long-term health of such entities remains to be seen.

E Asset Tokenisation

Blockchain technology, known for its role in powering cryptocurrencies such as Bitcoin and Ethereum, has the potential of revolutionizing the financial sector through its promising applications. One such application is asset tokenisation. Asset tokenisation involves converting real-world assets ("RWA"), and ownership and rights therein, into digital tokens, which can then be traded and settled on a blockchain.

Intent

Asset tokenisation has the ability to (i) make illiquid assets liquid; and (ii) 'break' non-fungible and indivisible RWAs into various fractions. This allows for multiple owners of the asset, wherein each owner of the asset independently owns each fractionalised asset.

This breaks several barriers for investors, allowing increased access to global real-world assets markets as transactions involving asset tokenisation occur through the blockchain—a decentralised platform. It enables investors with low capital to invest in a fraction without the need to invest in the whole asset. Tokenisation allows businesses to have access to a global pool of investors as well, which can be of advantage to small and medium sized businesses that may have difficulty raising capital through traditional methods.

Tokenisation can reduce the costs of transactions by eliminating the need for intermediaries such as banks and clearing houses, making it cost-efficient for businesses to access capital. Tokenisation can improve the efficiency of financial markets as it enables ease in trading assets and reducing the risk of counterparty default. This can lead to increased liquidity and lower prices for borrowers and investors. Automated processes through smart contracts saves time and cost by reducing operational overheads.

Asset tokenisation builds confidence amongst the stakeholders in the market by imbuing the main principles of blockchain—transparency and accuracy. All transactions registered on a blockchain are recorded and available to everyone interacting on that blockchain. The history of the asset can be traced with ease, ensuring that the asset is not manipulated by the seller in such a manner that the amount charged for the asset is more than the actual value of the asset.

Tokenisation is advantageous for the government as it makes it easier to track and tax asset transactions. This can help the government in funding essential services and reducing their budget deficits.

Impact

- Despite the advantages to asset tokenisation, there are technical and design-based challenges, as well as legal challenges in India, which include - Technical and operational vulnerabilities, including scalability;
- Uncertainty over settlement of payment instructions;
- Interoperability between different networks to allow seamless connectivity of different infrastructures;
- Network stability, robustness of market infrastructure and cyber-threats;
- Lack of clarity on the legal status of tokenised assets;
- Requirement of a standardised legal framework addressing issues such as investor protection, market manipulation, and financial crime;
- Amendments to regulations to be made by authorities such as the Securities and Exchange Board of India to allow the trading of tokenised assets; and
- Non-recognition of digital contracts by the Indian Contract Act, 1872.

Global Development

A number of foreign jurisdictions have already begun to explore the potential of asset tokenisation. In Germany, the Federal Financial Supervisory Authority has licensed a number of companies to offer tokenisation services. Luxembourg is often considered to be the "epicentre of asset tokenisation" as necessary technical and regulatory elements for blockchain deployment are in place and the focus is shifting to the practical implementation of the technology. In Thailand, the 'Emergency Decree on Digital Asset Businesses, 2018', establishes the legal foundation for running digital asset enterprises and offering investment and utility tokens.

The International Financial Services Centres Authority ("IFSCA") has established an Expert Committee on Asset Tokenization to examine the legal validity of smart contracts and establish a framework to develop regulations for tokenisation of real-world assets in India. Further, India's Decimal Point Analytics has received approval from Indian regulators to introduce tokenisation products within a sandbox and has received funding from the Hashgraph Group in this regard. The Telangana government has also recently announced the launch of a standard framework for tokenisation of assets.

Asset tokenization is a revolutionary technology that has the potential to unlock trillions of dollars in illiquid assets and make them more accessible to investors. It offers several advantages, including fractional ownership, global accessibility, and reduced transaction costs. There are several legal and operational challenges that need to be addressed before asset tokenization can be widely adopted. While India is still in the early stages of development, the establishment of an Expert Committee on Asset Tokenization by the IFSCA and the approval of tokenisation products in a sandbox by Indian regulators are positive signs.

Overall, asset tokenization has the potential to revolutionize the financial sector and make it more inclusive and efficient. However, more work needs to be done to address the challenges and develop a regulatory framework that supports its adoption.

F Regulating "Finfluencers"

Finfluencers are individuals who provide information or advice to people on various financial topics such as investing in securities, personal finance, banking products, insurance, or real-estate investment.

Intent

Social media platforms have become an essential communication tool in the post pandemic world. The advent of the COVID-19 pandemic led to a sustained rise of retail investors on stock exchanges , in an eager attempt to profit from the great COVID bull run. Ever more, retail investors have been heeding advice from influencers on social media platforms instead of approaching registered advisors. Such finfluencers use wide ranging business models to achieve their ends – from endorsing products for non-cash benefits to advertising products for platforms or producers in return for compensation. This has resulted in investors being misled , putting investors' money at risk and undermining the integrity of Indian financial markets by engaging in stock manipulation.

Currently, there is no specific law governing finfluencers. However, finfluencers are required to adhere to general regulations such as Section 12-A of the SEBI Act, 1992, which requires that no person shall directly or indirectly engage in any act, practice, course of business, which is fraudulent, misleading, or manipulative with respect to transactions on the stock exchange), and regulation 4 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003, which provides that any statement which is knowingly false, or misleading made to influence the investment decisions of investors will amount to "manipulative fraudulent or an unfair trade practice". Further, an "investment adviser" is defined under the SEBI (Investment Advisers) Regulations, 2013 as a person who "for consideration" provides investment advice to persons or group of persons. Since finfluencers usually do not charge their viewers and advice is publicly available for all, they fall outside the scope of "investment advisor".

Thus, to curb their growing menace, SEBI has joined hands with the Advertising Standards Council of India ("ASCI") and is striving to ensure that reliable and unbiased financial advice is available to all investors.

SEBI has released two consultation papers aimed at regulating finfluencers. The first paper focuses on the payments associated with the financial advice and education provided by finfluencers. It examines the business model and the payments made by investors to registered investment advisors or research analysts. The second paper delves into whether regulated entities, such as mutual funds and brokers, should establish partnerships with finfluencers.

Consultation Paper provides that:

1. Unregistered entities (finfluencers) are not allowed to work with registered intermediaries or regulated entities, or their agents or representatives, to promote or advertise their services or products;
2. Finfluencers registered with SEBI or stock exchanges or Association of Mutual Funds in India ("AMFI") in any capacity:
   - must include their registration number, contact information, contact number, investor grievance redressal helpline, and a disclaimer on any posts;
   - must make appropriate disclosure and disclaimer on any posts;
   - must adhere to the code of conduct outlined in terms of their relevant registration as well as any advertisement guidelines issued by SEBI, stock exchanges, or other SEBI-recognised regulatory authorities;
   - must not pay any trailing commissions based on the number of referrals as referral fees. However, stockbrokers shall be permitted to accept and pay referral fees for restricted referrals from retail clients;
   - entities registered/ regulated by SEBI or stock exchanges or AMFI shall not share confidential client information with any
   - unregistered entities.

Impact

The proposed regulation of financial influencers is a pivotal step in ensuring the integrity and transparency of financial markets. However, as financial influencers continue to play an increasingly significant role in shaping investment decisions and market trends, SEBI is likely to encounter several challenges in the future. Keeping up with emerging technologies and adapting regulations to cover online platforms effectively will be an ongoing challenge for SEBI. With the ease of cross-border communication and investments, SEBI may need to coordinate its efforts with international regulatory bodies to address influencers who have a global reach. Lastly, staying ahead of innovative marketing tactics and strategies employed by financial influencers to bypass regulations will be an ongoing battle. To conclude, SEBI's commitment to these challenges will be crucial in ensuring the credibility and stability of India's financial ecosystem in the years to come.

G Retail Invoice Discounting

“Retail invoice discounting” refers to the process by which a business can assign its trade receivables and assign them to a financial institution. The financial institution then advances an amount discounted against the receivable to the business. This allows the business to have readily available working capital, enabling ease of operations. When the customer pays the receivable amount to the financial institution, this amount is paid back to the business after deducting fees.

Basis this concept, there has been a rise in short-term financing platforms on which businesses can assign their unpaid invoices. Platforms such as KredX, OroWealth and TradeCred facilitate matching the businesses with suitable investors looking to make short term gains. Investors could range from individuals, banks, institutional investors and NRIs.

While the RBI has a “trade receivables discounting system” (“TReDS”) in place to regulate invoice discounting for MSMEs, invoice discounting for retail investors remains largely unregulated. This could pose risks for retail investors as they do not have recourse mechanisms in case of defaults, in the absence of regulatory protection.

Regulatory Support & Innovation

1 Innovations in Lending - Public Tech Platform for Frictionless Credit

Press Release on Public Tech Platform

RBI has announced the development of a public tech platform for enabling frictionless credit ("Platform") through its press release dated 14 August 2023.

Intent

The RBI has recognised that the data required for credit appraisal is available with different entities in separate systems, and that such data sets currently available in silos create hindrances in frictionless and timely delivery of rule-based lending.The Platform intends to enable delivery of frictionless credit by facilitating seamless flow of required digital information to lenders.It is intended to have an open architecture, open Application Programming Interfaces (APIs) and standards, to which all financial sector players can connect seamlessly in a 'plug and play' model.

Impact

- The RBI seeks to roll out the platform as a pilot project in a calibrated fashion, both in terms of access to information providers and use cases.
- In in its pilot phase, the focus will be on making available a range of financial products, including kisan credit card loans upto INR 1.6 lakhs, dairy loans, MSME loans (without collateral), personal loans, and home loans.
- This Platform will seamlessly integrate with essential services such as Aadhaar e-KYC, land records from various states, satellite data, PAN validation, Aadhaar e-signing, and account aggregation by account aggregators etc.
- Learnings from the pilot will guide the expansion of the Platform's scope to include additional products, information providers, and lenders.

2 National Health Claims Exchange

A National Health Claims Exchange is proposed to be set up by the National Health Authority. The platform will digitize and simplify the process of filing health insurance claims. IRDAI has notified the testing and adoption of Health Claims Exchange ("HCX") Specifications and e-claim standards on June 8, 2023. This will enable seamless interoperability of health claims processing. The NHCX, along with other building blocks of Ayushman Bharat Digital Mission ("ABDM"), will serve as a gateway for exchanging claims-related information among stakeholders present in the health care and health insurance eco-system including Insurers, TPAs, claimants, beneficiaries, health care and wellness providers etc.

Impact

The proposed process is not only quick and hassle-free but also reduces the cost per claim to the insurer, while policyholders and hospitals can track the claim status online and it also enables automatic fund transfer of the claim amount. The exchange will also help insurers to have a unified platform for claims and policyholders' medical history, which will help reduce the number of insurance frauds.

❸ Bima Sugam

Bima Sugam is a tech-driven application that will potentially serve as a one-stop shop or an online insurance marketplace for offering, buying, selling, renewing, claim settlement of insurance policies and all other related services.

The platform serves as an online insurance marketplace, similar to an e-commerce platform, where insurers have the opportunity to offer and sell their insurance products, and consumers can buy or renew their policies, raise claims, and receive all the related services at a single place.

Insurance plays a significant role in securing individuals and businesses against unforeseen risks. However, despite the importance of insurance, India's insurance penetration is still low, with only a small percentage of the population having insurance coverage. IRDAI has set a target of achieving insurance for all by 2047 and they have taken significant steps to promote innovation, competition, and distribution efficiencies in the insurance sector. With the aim of moving towards a principle-based regulatory regime, the regulator has introduced various measures to enhance the use of mainstream technology in the industry.

Key Benefits

Data Accessibility: Decision making of the insurance companies will improve as platform allow to access real-time, validated, and authentic data from various sources.

Reduced Paperwork: Policy management and claim process will become more efficient as intermediaries, agents, and policyholders will benefit from reduced paperwork.

End-to-End Solutions: Bima Sugam offers end-to-end solutions for insurance needs, enabling policy purchase, premium payments, and claims settlement on a single platform

Intent & Impact

Bima Sugam aims to streamline the entire insurance journey, from policy selection to claims settlement and renewals. All insurance requirements, including those for life, health, and general insurance (including motor and travel) will be met by the platform. Bima Sugam is designed in a manner where an e-Bima or E-IA account for policyholders would exist in a demat format to facilitate more safety. This would do away with the requirement of maintaining and safekeeping physical documents

❹ Fintech Repository

To ensure resilient growth and promote best practices, RBI has intended to set up a fintech repository. It will record information about fintechs which will include their activities, products, technology stack, financial information, among other things. Fintechs would be encouraged to voluntarily provide relevant information to the Repository which will aid in designing appropriate policy approaches.

Per industry experts, the RBI's proposal to create a fintech repository is a positive move for the industry, as it will further catalyse innovation by fostering transparency and improved collaboration among fintechs, other financial services industry players, and regulators. The approach to encouraging voluntary contributions from fintechs will empower regulators with real-time insights and enable informed, agile, and risk-mitigating decision-making.

The Repository will be operationalised by the Reserve Bank Innovation Hub in April 2024 or earlier, and guidelines on the same will be issued.

❺ Cloud Facility

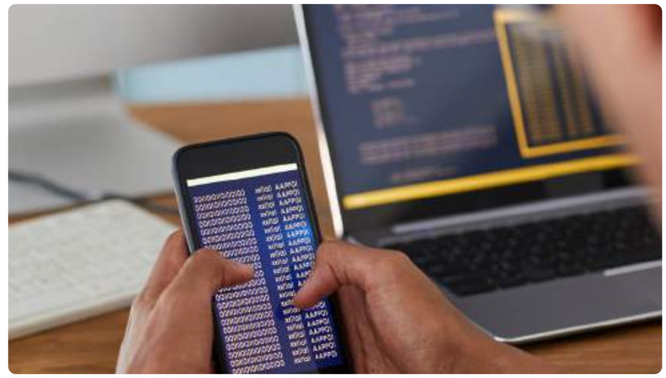
Reserve Bank of India in its monetary policy announcement in December 2023 announced RBI's intention to set up a cloud facility in order to enhance the security, integrity and privacy of data in the financial sector.

The cloud facility will be set up and initially operated by Indian Financial Technology & Allied Services (IFTAS), a wholly-owned subsidiary of RBI. Eventually, the cloud facility is sought to be transferred to a separate entity owned by the financial sector participants. Further, all the services provided by this entity will be data-led, be it infrastructure-as-a-service, platforms or services.

RBI's cloud initiative will address issues related to cybersecurity, data localisation, cost transparency, becoming a critical pillar for building consumer trust, data integrity, security, safety and future product growth.

❻ Regulatory Sandbox Mechanisms

Regulatory Sandbox usually refers to live testing of new products or services in a controlled/test regulatory environment for which regulators may/may not permit certain regulatory relaxations for the limited purpose of the testing. Regulatory Sandbox, at its core, is a formal regulatory program for market participants to test new products, services, or business models with customers in a live environment, subject to certain safeguards and oversight. It allows the regulator, the innovators, the financial service providers, and the customers to conduct field tests to collect evidence on the benefits and risks of new financial innovations while carefully monitoring and containing their risks. The aim is to foster responsible innovation in financial services, promote efficiency and bring benefit to consumers.



A SEBI Sandbox

SEBI stipulated an industry-wide sandbox with the development and adoption of fintech solutions in India. The aim of SEBI's sandbox is to involve eligible fintech start-ups and entities not regulated by SEBI to use the Innovation Sandbox for testing their solutions offline. Along with this, SEBI has introduced the "Regulatory Sandbox" framework for the purpose of allowing entities to experiment with fintech solutions live on real customers via regulatory relaxations.

The sandbox framework by SEBI was initiated to start an early dialogue with companies experimenting with innovative technologies.

The purpose of introducing the sandbox was to introduce innovative and technologically intensive products in the country to benefit investors, Indian markets, and Indian innovators. The introduction of the sandbox has enabled ease of accessibility for retail investors and reduced operational costs, which is particularly beneficial for investors with limited resources.

B RBI Regulatory Cohorts

The RBI sandbox scheme, introduced in 2019, is based on thematic cohorts. The first four cohorts were on "Retail Payments", "Cross-Border Payments", "MSME Lending", and "Prevention of Financial Fraud". In September 2022, the RBI announced the fifth cohort and based on feedback received from various stakeholders, it has been kept theme-agnostic.

Such cohorts have been successful in their objective of fostering innovation. For instance, the cohort on Retail Payments led to the approval of products such as phone-based offline payments using voice (the National Payments Corporation of India has given approval for UPI 123Pay) and offline payment solutions using SIM overlay smartcard, thereby allowing digital transactions to be made in areas with no internet connectivity. This has been a major step towards financial inclusion in the country.

Another example is the second cohort on Cross-Border Payments, which allowed for the testing products covering blockchain-based cross-border payment systems, digitization of documentation and processing, facilitation of the purchase of assets listed on foreign exchanges, and aggregation platform of cross-border payment service providers., This paved the way for a Bengaluru-based-neo-banking company to deploy its blockchain-based cross-border transaction monitoring product, which has gone on to receive an in-prinicple approval for a PA/PG license.

In-line with this theme of continuous innovation, the RBI has also made available the certain cohorts for 'On Tap' applications, which means that players can apply to work on past cohort themes .

C IRDAI Sandbox

The Insurance Regulatory and Development Authority of India (IRDAI) in its first tranche in 2020, approved 33 products on non-life and health insurance, including fitness trackers, app-based diabetes wellness programs, wearable devices for existing customers, etc. In its second tranche, it approved 16 products including products on motor insurance, trade credit insurance for SMEs, and parametric insurance in its second tranche. The approval has been given to Bajaj Allianz General Insurance, Tata AIG, Go Digit General Insurance, Reliance General Insurance, ICICI Lombard, India First Life Insurance, HDFC Life Insurance, and ICICI PruLife.

Through an amendment, the IRDAI has suggested increasing the experimental period of the regulatory sandbox from the existing 6 months to up to 36 months, with the objective of promoting innovation in the insurance sector. The process of filing applications has been made perpetual as well.

On 31 March, 2023, IRDAI invited applications for the third tranche, with the theme “regulation as an enabler.” The pilots for this include crowdfunding of insurance premiums, as well as wearables-linked health insurance, wherein the customers are encouraged to adopt good behavior through rewards. The third tranche also includes another pilot project by Digit, which offers group products to every eligible employee of the employer. The IRDAI sandboxes have seen innovations being made in the area of “insurtech”, with concepts such wearable devices, app-monitored wellness programmes and pay-as-you drive motor insurance technologies being developed.

D PFRDA Sandbox

The Pension Fund Regulatory and Development Authority (“PFRDA”) has established the Interoperable Regulatory Sandbox (“IoRS”) for testing innovative financial products. The PFRDA has considered coordinating with Nascom to identify areas under the National Pension Scheme that may require fintech for the beneficiaries of the National Pension Scheme. Two factors shall be looked into by the regulators while considering applications from applicants for a product to be tested in the regulatory sandbox— first, the enhancement of already existing products such as loans and insurance and the relaxations that have been sought for undertaking the tests.

E IFSCA Sandbox

The International Financial Services Centres Authority (“IFSCA”) introduced a framework for “Regulatory Sandbox” to be operable within the IFSC operable at GIFT city. Under the IFSCA (FinTech Incentive) Scheme, 2022, certain grants were notified with the aim of establishing a “World Class Fintech Hub” at GIFT IFSC (International Financial Services Centre), India—including sandbox grant for fintech entities to experiment products or services in a IFSCA’s sandbox.

Under this Sandbox framework, entities operating in the capital market, banking, insurance and financial services space shall be granted certain facilities and flexibilities to experiment with innovative fintech solutions. Regulated and unregulated entities in capital market, banking, insurance and pension sectors, along with individuals, start-ups FATF compliant jurisdictions can participate in the IFSCA sandbox.

IFSCA launched a series of Hackathons. The objective of the Hackathon “I-Sprint’21” was to shortlist fintechs which would be given entry into IFSCA’s Regulatory Sandbox. The first sprint focused on the banking sector, the second sprint focused on the next generation bright minds from the most coveted Universities/Institutions, while the third and fourth sprints focused on InsurTech and MarketTech.

Sandbox - Global Regulatory Benchmarking

Eligibility to Participate	Singapore	UK	Hong Kong	Malaysia	UAE	Bahrain	India
Open to 'passporting' - access to foreign players	✓	✓	✓	✓	✗	✓	✗
Sandbox traditionally focused on both startups & incumbents (vs only startups)	✓	✓	✓	✗	✗	✗	✓
Need of up-front License before entering the sandbox	✗	✓	✓	✓	✓	✗	✓

Sandbox Process	Singapore	UK	Hong Kong	Malaysia	UAE	Bahrain	India
Different types of Sandbox (Sandbox Express, Scalebox etc.)	✓	✓	✗	✗	✓	✗	✗
Applications & enrolment throughout the year (rather than slot-based applications)	✓	✓	✓	✓	✗	✓	✗
Maximum Sandbox journey duration	12m	6m	Variable	12m	6-12m	12m	6m
Maximum Extension beyond Duration of Sandbox	1m	Variable	Variable	Variable	Upto 12m	Variable	Variable

Evaluation	Singapore	UK	Hong Kong	Malaysia	UAE	Bahrain	India
Fintech Division as a decision-making authority	✗	✓	✗	✗	✗	✗	✓
Evaluation based on innovation only (vs Innovation + Business case consideration)	✓	✗	✓	✗	✗	✓	✗
Exit feedback is formal & structured (vs feedback at regular intervals & informal/ unstructured exit feedback)	✗	✗	✗	✓	✓	✓	✗

Best practices which India can adopt

[1] Viability" from RBI framework evaluation criteria assumed as Business case criteria

[2] Assumed as no mention of exit feedback in RBI framework

Source: Central Banks, Press search, RBI Framework

About Varanium

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T.S Anantakrishnan
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About Cyril Amarchand Mangaldas

India's leading law firm

Cyril Amarchand Mangaldas (CAM) is India's leading law firm with a global reputation of being trusted advisors to its clients. Tracing its professional lineage to 1917, CAM was founded to continue the legacy of Amarchand & Mangaldas & Suresh A. Shroff & Co. - whose pre-eminence, expertise and reputation of almost a century was unparalleled in the Indian Legal Fraternity.

The Firm advises a large and diverse set of clients, including domestic and foreign commercial enterprises, financial institutions, private equity funds, venture capital funds, start-ups, government and regulatory bodies. With 850 lawyers and over 150 Partners , the firm is the largest full-service law firm in India and offices in key business centres at Mumbai, Delhi-NCR, Bengaluru, Ahmedabad, Hyderabad, Chennai, GIFT City and also in Singapore.

Central to the firm's culture, is its Ahead of the Curve mindset. At CAM , foresight and innovation lie at the foundation of everything the firm does, to keep its clients ahead of their legal and business challenges. The firm has been at the forefront of innovation in the Indian legal market, often breaking new ground where no precedent exists. By looking ahead, the firm anticipates challenges and pushes itself to deliver complex, practical solutions to their clients.

Practices at CAM have been consistently recognized as tier-1 practices for their outstanding performances, with such recent recognition being in the IFLR1000 Rankings, 2023. CAM has been recognized as the best overall law firm at the IBLJ Indian Law Firm Awards, 2023 and one of the top 50 innovative companies of the year by the CII Industrial Innovation Awards, 2023.

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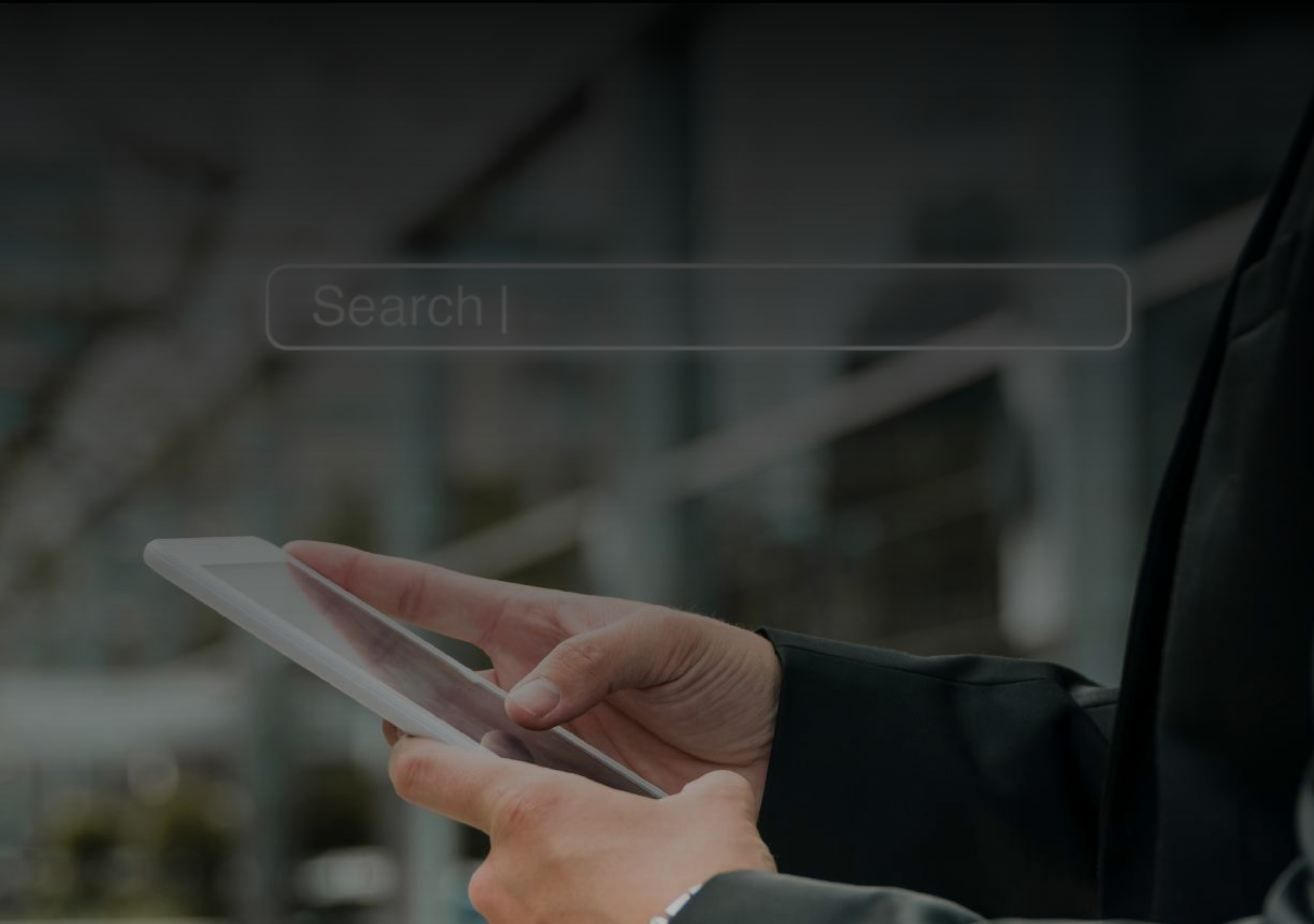

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- [See Chapter IX, Part V]

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